2010 EDITION

The JBWay

How to Maximise Returns and Minimise Risk on the Share Market

bear cottage

an initiative of the children's hospital at Westmead

JUSTIN BEETON

JB Global Investment Services

THE JB WAY

First Edition June 2009
Second Edition June 2010

ISBN 978-0-646-50929-7

The JB Way

How to Maximise Returns and Minimise Risk on the Share Market

Justin Beeton

Important Information

- This information is current as at 1st June 2010.
- The information contained in this book is general information only. No part of this book is to be construed as a solicitation to buy or sell any security or financial product. The author, in preparing this book, did not take into account the investment objectives, financial situation and particular needs of any particular person.
- This information is not an offer to issue any security or financial product and no part of the book is to be construed as a recommendation to make a financial investment.
- Past performance is not a reliable indicator of future performance.
- The sample strategies, case studies and any examples (including any assumptions or figures) contained in this book are hypothetical and are not actual or potential returns, estimates, projections or forecasts for investments. The strategies and case studies are based on assumptions which might have a material effect on returns.
- The sample strategies, case studies and any examples do not take into account taxation. You should consult an Accountant to determine the tax consequences based on your individual tax situation. The results could differ significantly when tax is included.
- Every effort has been made to ensure that this book is free from error or omissions. However, the publisher, the author, the editor, or their respective employees or agents shall not accept responsibility for injury, loss or damage occasioned to any person acting or refraining from action as a result of material in this book whether or not such injury, loss or damage is in any way due to any negligent or omission, breach of duty or default on the part of the publisher, the author, the editor or their respective employees or agents.

Acknowledgements

I would like to express my gratitude to all those who have given me the opportunity to write this book:-

To my beautiful wife, Bec; to my brother, Scott; and to my Mum, Pam – thank you for your patience, endless love, encouragement, strength and continual support. My debt to the three of you is beyond measure.

To the team at JB Global – one of the greatest joys of JB Global is that it has given me the opportunity to surround myself with an intelligent, talented and dynamic team. Thank you for your tireless support, insightful comments and contributions to this book. It is a pleasure and privilege to work with you all.

While many people have provided guidance to help me discover and continually modify *The JB Way*, I would not be the person I am today without my Grandfather. Unfortunately, my Grandfather passed away recently. My Grandfather always encouraged me to follow my dreams and live life with the highest standard. His extensive business guidance, his business ethic, and his belief in my abilities as a human being have molded my values to develop who I am today. I dedicate this book to the memory of my late Grandfather, Lionel.

Many people have gone further than they imagined they could just because somebody else thought they could.

ABOUT THE AUTHOR – JUSTIN BEETON

Justin Beeton is an Australian entrepreneur, successful investor, public speaker and author.

Having bought his first share at age 14, Justin is now an experienced investor and investment adviser. Those first shares sparked an interest in the share market that has grown into a consuming passion. Throughout his career, Justin has confirmed the old adage that to create wealth, you don't necessarily need to work hard for your money – the most important thing is to make sure that your money is working hard for you.

Justin worked as a stockbroker and investment adviser before founding JB Global in 2004. In six years JB Global has grown to have over 3,000 clients, $550 million in funds under management and has offices in Sydney, Melbourne and Brisbane.

JB Global has been twice recognised by the Business Review Weekly's coveted Fast Starters list. JB Global was ranked as the fastest growing Finance and Investment Services Company within Australia. The company offers a portfolio of powerful and proven investment strategies developed by Justin, based on enabling investors to access the high potential gains available through the share market whilst significantly reducing risk.

Justin's commitment to ethical business is demonstrated through JB Global's $100 million renewable energy investment. JB Global is at the forefront of ethical investment and has brought this form of investment within reach of everyday Australians.

Justin holds a Bachelor of Commerce Degree, a postgraduate degree in Applied Finance and Investment, derivatives accreditation and is a licensed investment adviser, stockbroker and financial planner. When he's not focused on the share market, he enjoys spending time with his family, rugby union, cricket, skiing and golf.

FROM THE AUTHOR

People often ask me what the secret to the share market is, and the answer is very simple – Warren Buffett explains the rules to investing and creating unlimited wealth as:-

Rule No. 1 "Never lose money"
Rule No. 2 "Never forget Rule No. 1"

This sounds simple in principle, but is usually very difficult to implement without compromising returns.

I have spent over 15 years studying Warren Buffett, researching financial markets and analysing investment philosophy, all in an attempt to discover how Warren Buffett never loses money yet still achieves phenomenal returns.

I have been searching for the investment philosophy that many fund managers, stockbrokers and financial planners have spent their entire career searching for. I have been searching for the perfect investment. I have been searching for the "Holy Grail" of investing. That is, I have been searching for an investment philosophy that offers maximum returns combined with minimum risk!

This book outlines my findings.

The JB Way is the solution to what so many investors and professionals have been searching for! That is, *The JB Way* is an investment philosophy that minimises risk whilst still giving the investor the capacity to enjoy phenomenal returns, similar to those achieved by Warren Buffett.

The JB Way provides unlimited profit potential combined with very low risk. That is, you do not need to take on huge risk to achieve high returns with *The JB Way*.

Surprisingly, *The JB Way* does not involve expensive software systems, costly subscriptions to stock reports or investor magazines. You also do not need a degree in advanced economics to understand the principles.

Do not expect your stockbroker to endorse this approach as, in practice, it contradicts their livelihood, likewise that of the Australian Stock Exchange.

The JB Way is simple, safe and successful!

Throughout this book, I have quoted the world's most successful investor, Warren Buffett. This man is an investment genius. These quotes have motivated and inspired me to view the investment world through a different lens. If I have done my job as an author and educator, then by the end of this book you will too.

Happy investing,

Justin Beeton

Contents

Chapter One

Investing

I have studied for the past decade many generations of leading investors including: – Warren Buffett, Charlie Munger, Benjamin Graham, Steve Forbes, Sir John Templeton, Robert Kiyosaki, Richard Branson and Kerry Packer. I studied these investment gurus in an attempt to become an even more successful investor.

Underlying all of these investment gurus' genius' is to firstly, **save,** save now and save often. Secondly, is an understanding of the extraordinary power of **compounding**. Thirdly, **capital preservation**. To this we must also add the important investor characteristics of courage, self-confidence and **discipline**.

Save, Save Now, Save Often

Achieving any investment results first requires savings. Save, save a lot and save often. Then take steps to ensure that your savings are working as hard as they can for you.

You cannot save and consume. It is an unfortunate law of economics. The idea of saving is to sacrifice consumption now, in order to ensure greater consumption in years to come. That is, investing is all about deferring your consumption to afford more improved lifestyle needs and wants in the future.

People tend to buy the most expensive clothes, the most expensive car and the most expensive TV that they can afford at that time. All this money could have been invested. You need to make a conscious decision as to what really matters. Is it more important to be buying a new car that will depreciate by 25% as you drive it out of the car dealership? Or is it more important to achieve the lifestyle you desire in retirement to travel, play golf or give your grandchildren a better education, and of course, let's not forget the option of retiring earlier!

Save, save now, and save often can also be translated into invest, invest now and invest often.

The Compound Effect

A big mistake that investors or traders frequently make is trying to time the market. If you look at the net returns throughout history there is a clear message – TIME is the key to creating wealth, not timing!

"Time is the friend of the wonderful company,
the enemy of the mediocre"

Warren Buffett

The reason Warren Buffett is so wealthy is because he is old. Warren Buffett simply understands the principle of compounding – that is the importance of investing for a long period. A long period of time is not six months, one year or two years, or even three years. Warren Buffett has been investing in the share market since the 1940's – for most of us this is a lifetime.

Example – Why Compounding is such a beautiful thing

Let's assume that your annual income is $35,000. To keep the numbers simple, let's also assume you never receive a pay rise in your entire working life. However, you do understand the concept of saving and therefore invest 10% of your salary each year from the age of 18 to the age of 65.

If you achieve a 10% return each year over the entire period, then the wealth you would have accumulated by the age of 65 would be over $3 million! A staggering result, given such a relatively moderate salary, saving only $7 per day and assuming no income growth over the entire 47-year period.

If you achieve a 14% return each year (a rate similar to the long-term average growth rate of the Australian share market), the amount of wealth that you would have accumulated at the age of 65 would be almost $12 million.

This is the value of compounding. The compounding effect has the capacity to significantly change your life. It just takes TIME.

"I never attempt to make money on the share market.
I buy on the assumption that they could close the market
the next day and not reopen it for five years"

Warren Buffett

Compounding is the "tortoise" way to create wealth – slow and steady wins the race. Just start early, keep plodding, and don't lose focus on what really matters. That is your long-term goals.

If you are not 18 like in the example, don't worry. You can still become independently wealthy, but you might need to save a little more than $7 to reach your retirement goals, or take on more risk to hopefully increase returns. Either way, whether you are 18, 40, or 65 years old, the best time to start investing is today. You need to take action, develop an investment plan as soon as possible and start investing. Then sit back and enjoy the wonderful benefits of compounding.

"The only difference between a rich person and a poor person is how they use their time"

Robert Kiyosaki

Capital Preservation

Capital preservation (or capital protection) in simple terms means 'don't lose what you already have.'

Capital preservation involves not taking a gamble on the latest "hot tip." This is often referred to as "speculating." I believe there is a big difference between investing and speculating. During the Dot.Com bubble there were many companies with billion dollar market caps, despite the fact that those companies had not made a single dollar in revenue, let alone a profit. In 99% of those cases, the companies vanished very quickly, as did the investors money.

Capital preservation also involves building a general understanding of the various investments available, and most importantly the risks involved in each of them. Be sure you know what you are investing in. There are a lot of people out there who will sell you anything with the promise of making a quick buck.

It is up to you to do your homework and educate yourself about investing. Ideally, our school system would teach students about how to deal with money and investing. Unfortunately, there is a notable absence on how money and investments work. The school system passes the obligation of education in this area to parents. Further, unfortunately a large number of parents themselves are not educated enough in this area, having only learnt the hard way, which is often through the 'school of hard knocks.'

Some of our parents and grandparents were led to believe that you left school, worked hard and then retired to live on the government pension, which is how some of them lived their lives. If our generation were to follow in their footsteps then we will end up in the same place. I believe that the government needs to step-in and make a change. This change should be made early with education about money and finances as part of the core education program at school.

"Risk stems from not knowing what you are doing"

Warren Buffett

Discipline

"Everyone is a disciplined long-term investor until the market goes down"

Steve Forbes, Editor-in-Chief of Forbes magazine

Discipline involves firstly having a plan and then sticking to it.

"A good plan violently executed today is far and away better than a perfect plan tomorrow"

General George S. Patton

All successful investors, or successful people for that matter, always have a plan. For all the geniuses mentioned above this plan was not an overnight strategy, but one that has involved almost their entire lifetime.

This book outlines a possible investment plan that can assist in guiding you to achieve your investment goals and objectives. However, before you can determine whether *The JB Way* is suitable, you must first determine your investment goals and the amount of risk you are prepared to take.

These goals should be your long-term investment objectives. That is, they must be at least three-years-plus goals. Ask yourself what do you want to achieve from your investments in ten years time?

Discipline sounds very simple, but it is extremely difficult when it comes to investing. You must keep your focus on your long-term investment goals and never be distracted by short-term market noise. Never deviate from your investment plan just because of short-term market movements.

Other important characteristics that are required to be a disciplined investor are sacrifice and patience.

"I think sound investing can make you very rich if you are not in too big of a hurry. And it never makes you poor, which is even better."

Warren Buffett

Chapter Summary:-

- Save, save now, and save often.
- You cannot consume and invest – it is an unfortunate law of economics.
- Investing is all about deferring consumption to afford more improved needs and wants in the future.
- Investment success is all about "time," not "timing."
- Attempting to "time" the market is a mistake which will only lead to under performance over the long-term.
- Do not risk what you have already worked so hard to accumulate.
- Invest in your education.
- Investment success involves having a plan and then being disciplined to stick to it, without responding to short-term market movements.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

"Learn to walk, then learn to invest. I'm depending on you to look after me when I grow old."

Chapter Two

Introduction to the Australian Share Market

The transformation of the Australian Share Market over the last 20 years has been amazing, boosted largely by the participation of close to 50% of the Australian population who now own shares directly. Many more own shares indirectly through managed funds or within their superannuation.

The reason more Australians now look to invest in the share market than ever before is because many Australians now realise share investing can be even more attractive as an asset class to accelerate long-term wealth, than that of their traditional obsession with acquiring property.

That being the case, share investing is not easy, there is no quick buck to be made or get rich quick solution to be found within the share market. However, by taking a sensible, disciplined, long-term approach you can create wealth from the share market far beyond your wildest dreams.

Most Australian's have heard of the share market. But really what is a share?

A share is simply part-ownership of a company. As a shareholder, you own a portion of a company. This portion could be large or small, depending on the number of shares held and the overall size of the company.

The share market is a place where investors can buy and sell their shares on a daily basis.

The long-term benefits of the share market

Income

As a shareholder you are entitled to receive your share of business profits. You receive this through payments called "dividends." You might also receive tax credits for tax paid by the company. These tax credits are called "franking credits."

It is important to point out that not all companies pay a dividend as some companies might not make a profit, and others might keep profits to fund future growth.

Voting Rights

As well as your share of profits, as a shareholder you are entitled to attend and vote at shareholder meetings. This gives you some control over the future direction of the company. The extent of this control depends obviously on the number of shares you hold.

Liquidity

Another advantage of the share market is that each day there is generally an offer for someone to buy and sell the shares that you own. Shares are the most liquid asset class second only to cash itself. Shares can be sold at a click of a button and those funds deposited into your bank account three business days later. This ensures investors know exactly at any point in time what their shares are worth.

Low transaction costs

The costs involved to buy and sell shares are also very cheap when compared to property. The transaction costs to buy and sell a direct property can be over 5% when you consider stamp duty, legal fees, and agent commissions, in comparison to shares which should be no more than 1%.

Flexible

Shares are also very flexible as you can sell a portion of your holdings if you require capital, whilst you cannot off-load a bathroom or bedroom of a property.

Capital Growth

There are many advantages of investing in shares, but the main reason so many Australian's now own shares is to profit from the capital growth of a particular company. As the company share price rises, as a shareholder, so too does the value of your investment.

The share market has historically offered the highest returns than any other asset class.

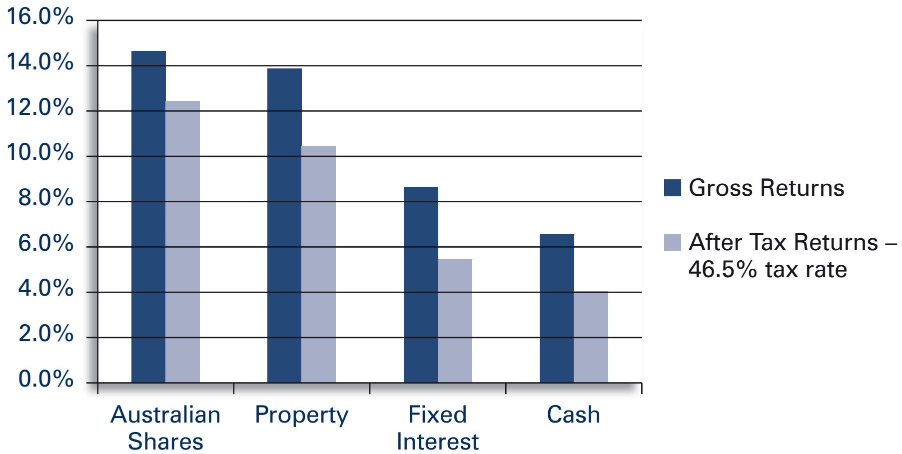


Figure 2.1 – 20 year comparative asset performance since 1985

As we can see from Figure 2.1, Australian shares have historically provided the highest return over the time period relative to all other asset classes, both on a before and after tax basis. Shares have even outperformed property by approximately 2% per year.

While 2% doesn't sound that much given the increased level of risk usually associated with shares, the difference over time in actual dollar returns is huge.

Table 2.1 compares a $100,000 investment in both property and Australian shares. Shares have returned $551,253 more than property over the 25 year period.

Year	Australian Shares	Property	Difference
1980	$100,000	$100,000	0
1985	$198,526	$190,858	$7,668
1990	$394,125	$364,269	$29,856
1995	$782,440	$695,239	$87,201
2000	$1,553,347	$1,326,922	$226,425
2005	**$3,083,795**	**$2,532,541**	**$551,254**

Table 2.1 Comparative dollar returns – Shares vs Property

Back in 1980, $100,000 invested in the All Ordinaries index would have accumulated to over $3,000,000 by 2005. Granted, there were years that the share market rose, and there were years where the share market fell. However, the overall result is that the investor would be significantly better off investing in shares as opposed to any other asset class.

So, what we do know is that, in the past, Australian shares have been a great investment. Therefore, does it not make sense to invest in the share market? Does it not make sense to adopt a long-term approach to investing? Does this make it easier for us to make money out of the share market? The answer to this question is yes.

Whilst shares consistently outperform all other asset classes over the long-term including property, owning shares is considered by many to be too risky.

Share Market Risks

Risk is just the probability of losing money, and granted, shares are risky.

Risk for shares comes about from three main forces – Stock specific risk, international risk and market risk.

Stock specific risk relates to the profitability of the individual company itself. Examples include Allco, MFS, HIH, Onetel, ABC Learning and Centro Property Group. In all these cases, profitability declined resulting in the underlying share prices of the specific company depreciating significantly.

International risk and *market risk* refers to events beyond the control of the business including the performance of the economy, interest rates and movements in international markets.

In the short-term, we see several price movements both up and down. The level of price movement is expressed by the term volatility.

When we see high levels of volatility, the share market is considered to be at its highest level of risk. This is because there are large price movements in shares traded. I will explain how we can mitigate this risk later. However, for now, all we need to know is that an investment in shares involves risk.

While risks exist, the main reason so many investors lose money when it comes to share investing has nothing to do with stock specific risk, market risk or international risk, but because of how the individual investors react to short-term price fluctuations. That is, they lose money because they act on short-term emotions of fear and greed, as opposed to following their long-term investment discipline. There will be more on the emotions of investing later.

Risk return trade-off – the Efficient Frontier

When we study risk, we are told that the level of return we can achieve is directly related to the amount of risk taken. However, as investors, really what we want to achieve from an investment is the maximum amount of return with minimum risk. This would be the "Holy Grail" when it comes to investing. That is a perfect investment – to make as much money as possible and to risk nothing.

However, we are led to believe time after time that this is impossible. We are educated that the potential return is directly related to risk. This is expressed through the "Efficient Frontier."

The "Efficient Frontier" says that, whilst shares represent the greatest level of risk, they also represent the greatest level of potential return. Property represents a lower level of risk than shares, but a lower potential return. Cash represents the least level of risk, but the least potential return. There is a consistent theme here – the more risk you take, usually the higher the potential return.

The Efficient Frontier concludes that for an investment to be considered 'efficient,' that investment must offer the maximum expected return for a given level of risk.

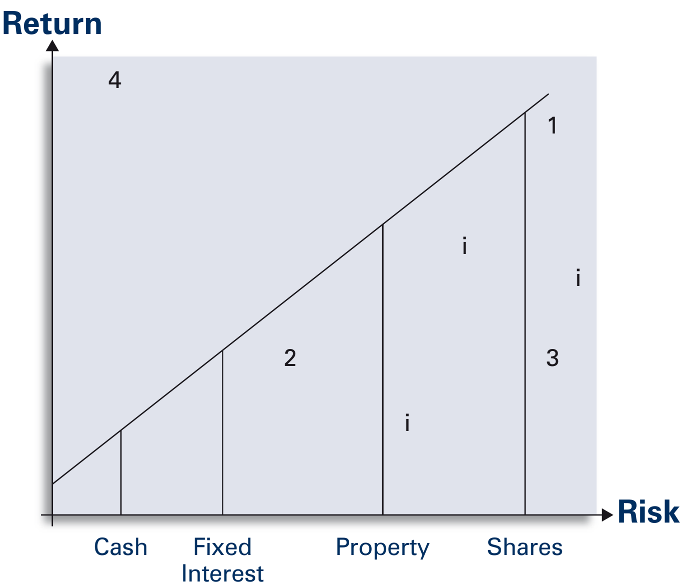


Figure 2.3 – The Efficient Frontier

Investment 1 is preferred to Investment 3, because that investment offers a higher expected return for the same level risk. Likewise, Investment 2 is preferred to Investment 3, because it offers the same expected return for lower risk.

The problem with most fund managers, stockbrokers, financial planners and investors is that they are achieving low returns, yet taking on high levels of risk. These results are indicated by Points 'i' on Figure 2.3.

The Efficient Frontier implies *The JB Way* is merely a myth, that there is no such thing as high potential returns with minimal risk.

So is *The JB Way* achievable?

If *The JB Way* was not just a myth and was in fact achievable, the risk return payoff would be represented by Point 4 on Figure 2.3 – Maximum Returns with Minimum Risk. The high potential returns capable only from the share market, yet with a risk exposure similar to merely holding cash.

If we could eliminate the downside risk of owning shares, but keep all the upside potential, have we proved the Efficient Frontier wrong? Have we achieved the "Holy Grail" when it comes to Investing? Have we achieved the perfect investment?

Thankfully, financial markets continue to get more and more sophisticated as time progresses. I believe that the Efficient Frontier is outdated. I believe that the Efficient Frontier has been proven wrong by *The JB Way*. I believe an investor can pursue high returns whilst only being exposed to minimal risk. I will explain *The JB Way* investment philosophy in detail soon.

Chapter Summary:-

- A share is simply part-ownership of a company.
- Shareholder benefits include dividends, voting rights, tax advantages, liquidity, low transaction costs and flexibility.
- The main reason to own shares is to profit from capital growth of the underlying company.
- Shares have historically provided the largest return to investors over the past 20 years.
- Traditional share market investing involves a high level of risk.

- Share market risks include:-
  - Stock specific risk
  - International risk
  - Market risk
- Modern investment theory suggests that the potential return is directly correlated to risk.
- If we could eliminate the downside risk of owning shares, but keep all the upside potential returns, we have proved modern investment theory wrong and discovered the “Holy Grail” when it comes to investing. That is, the perfect investment.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

Chapter Three

Trading vs Investing

"In the short run, the share market is a voting machine. In the long run, it's a weighing machine. Weight counts eventually, but votes count in the short-term. Unfortunately, they have no literacy tests in terms of voting qualifications. Most people learn the hard way."

Warren Buffett

There are two types of people who buy and sell on the share market. There are traders who buy and sell frequently in the hope to make a short-term profit, and there are investors who buy and hold for a long period.

Many people day in and day out try to beat the market in the short-term. The unique thing about short-term trading the share market is that for every winner, there is a loser and for every loser, there is a winner.

Many clients come into our offices wanting to invest to change their life. This is great, as investing indeed has the potential to change your life. However, as most share investors do, these clients generally monitor their investments on a daily, weekly or monthly basis. Are these clients really looking to change their life or are they merely looking for a hobby and something to do? Can short-term traders practically always beat the market? Can it be possible to beat the market year after year?

I look to Warren Buffett for the answers to these questions.

Warren Buffett does not try to beat the market by trading. He does not buy and sell based on short-term market fluctuations. He identifies companies that represent good value and holds them hopefully forever.

"If you don't feel comfortable owning something for 10 years, do not own it for 10 minutes."

Warren Buffett

So, is successful investing all about timing? Or, is successful investing all about investment time?

"You do things when opportunities come along. I've had periods in my life when I've had a bundle of ideas come along, and I've had long dry spells. If I get an idea next week, I'll do something, if not, I won't do a damn thing."

Warren Buffett

Warren Buffett has repeatedly criticised the finance/stockbroking industry for what he considers to be a *"…proliferation of advisers who add no value but are compensated based on volume of transactions which they facilitate."* **Warren Buffett**

He continues to point out that the growing volume of trades is evidence that an even greater proportion of investors gains are going to stockbrokers and other intermediaries – financial planners, fund managers and the like.

What would happen to stockbrokers, or the Australian Stock Exchange for that matter, if we all invested like Warren Buffett? As Warren Buffett only buys a few companies and holds those shares hopefully forever, stockbrokers would be paid brokerage only once. As they are paid when you buy and sell, a huge conflict of interest exists. Stockbrokers are incentivised to make you trade frequently, the more often the better. They are not remunerated by making you money. This relationship stinks and needs a serious overhaul.

"We believe that according the name 'investors' to institutions that trade actively is like calling someone who repeatedly engages in one-night stands a 'romantic'."

Warren Buffett

Some traders argue that today's share markets are more efficient, making it easier to profit from short-term trading. I agree that today's share markets are larger, deeper and offer more choices than ever before, but today's markets involve greater noise than the markets of the past.

In the information age that we are in, it is easy to get caught up in the short-term market fluctuations. These market movements are driven by the media and the short-sighted approach of fund managers, who are driven by quarter-to-quarter performance reporting.

With the speed of the internet, greater access to information in chat rooms and message boards, trading volume and price volatility has increased significantly. This increased market noise makes it even more difficult for short-term traders to make money.

If "efficient" means price equalling value, these fluctuations mean that the market is in fact less efficient than the past. That being the case, these inefficiencies create outstanding investing opportunities for those investors who decide to buy and hold for the long-term.

I am yet to meet a short-term trader that has made consistent returns over the long-term. Some get lucky and make money for a few weeks, or months, some even for a few years, but they eventually lose not just those gains but almost everything they have. These same traders then refer to the share market as being just like gambling, and they are right. If you trade the share market or speculate, the risks are extremely high and therefore short-term trading is very similar to gambling. However, if you invest for the long-term, you can make huge gains from the share market.

Many investors have become multi-billionaires, just like Warren Buffett, from the share market – not by trading, but by investing for the long-term. The difference between an investor and a trader is merely their planned holding period. Provided you are an investor (which implies a long-term holding period), you can accumulate a large wealth from the share market.

Chapter Summary:-

- Trading or taking a short-term focus on the share market only leads to poor performance.
- It is appropriate that I highlight the importance that you do not confuse trading or timing the market as the way to make money from the share market. This merely makes your stockbroker wealthy.
- You can never consistently pick the bottom of the market. Attempting to time the market only leads to financial pain.
- If you want to make consistent returns from the share market, simply copy Warren Buffett and be a long-term INVESTOR.

- Did I mention, invest for the long-term?!
- Many investors have become multi-billionaires directly from the being a long-term investor.
- The share market has historically provided the highest returns, significantly outperforming all other asset classes.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

Warren Buffett

When it comes to investing, arguably there are none better than Warren Buffett.

According to the Forbes magazine, Warren Buffett, as at July 2008, is the world's richest man with a whopping $62 billion net worth.

Buffett, known as the Oracle of Omaha, was born on 30th August 1930. Son of a stockbroker/politician, his first job was as a newspaper delivery boy. At the age of 13, he filed his first tax return and claimed $35 as a deduction for his bicycle.

When you look at Buffett's job description it states 'Investor.' That is, Buffett has accumulated his entire fortune from simply investing.

Warren Buffett is a very simple man, he is known for his unconventional style despite his huge wealth. He continues to live in the same home in Omaha which he bought in 1958 for $31,500 (today's value, approximately $700,000). His salary of approximately $100,000 which he drew in 2006 is merely pocket change in terms of standard executive remuneration.

Buffett is also the world's largest philanthropist. In 2006, he announced plans to donate a large portion of his fortune to charity with the majority going to the Bill & Melinda Gates foundation. At the time of the announcement, the amount was the largest charitable donation in history.

Buffett does not have any quirky products (i.e. Gates, third wealthiest man with Microsoft) and was not born into wealth like James Packer (Australia's richest man as at March 2008). Buffett simply understands the concept of compounding, he is an extremely disciplined investor, and has complete control over his investment emotions.

In the 1950's, as a graduate student at Columbia University, Buffett studied economics under legendary investor, Benjamin Graham. He later worked for Graham's company. After Graham retired in 1955, Buffett (at the young age of 25) returned home to Omaha where he established his own investment firm.

Buffett (as a 25 year old) started a limited investment partnership, with seven partners who together contributed $105,000. Over the next thirteen years, Buffett compounded the funds at an annual rate of 29.5%. The Dow Jones declined in price in five of the thirteen years, yet Buffett's partnership never had a negative year.

In 1962 (seven years later), Buffett began buying shares in Berkshire Hathaway. By 1965, he controlled the company. At the time of writing this book, shares in Berkshire Hathaway were valued at approximately $140,000 per share. If you had invested $10,000 into Berkshire Hathaway shares in 1965 when Buffett took control of the company, those shares today would be worth almost $100 million. As his initial investment was merely $100 (at 25 years of age), thirteen years later this was worth $25 million, and today a whopping $62 billion. This achievement contributed to Buffett recently being voted the greatest investor of the 20th Century.

Warren Buffett's Investment Philosophy

If there is one thing I have learnt about Buffett in the last 15 years of studying his genius, it is that Buffett buys businesses – he does not buy sectors, countries, ideas or fads. Buffett never bought into the Dot.Com frenzy that dominated the 1990's and early 2000 boom, only because he could not find a company within the sector that met his investment formula.

This formula is well-defined, but the key component is Buffett's discipline to adhere to his formula and not deviate away from his principles at any time. To this I must also add the all important characteristics of courage, self-belief and confidence in times of market volatility.

Warren Buffett's Investment Philosophy:-

1. Buy outstanding companies;
2. Adopt a focussed investment philosophy;
3. Put the bulk of your money into those companies; and
4. Hold steady during short-term market volatility.

Overriding all four of these components is the necessity to invest for the long-term – that is TIME.

1. Buy Outstanding Companies

"If a business does well, the stock price eventually follows"

Warren Buffett

The companies chosen by Buffett must all have a long history of superior performance, measured only by earnings growth and a strong proven management team. These traits indicate a high probability that the company will continue to perform in the future as they have done in the past. The performance will only be measured over years – not each day, month or quarter – through profitability, and profitability alone.

Buffett then only buys such companies when the price is less than the intrinsic value. That is, the price is cheap.

"It is far better to buy a wonderful company at a fair price, than a fair company at a wonderful price"

Warren Buffett

So the first step of Warren Buffett's investment philosophy is to buy outstanding companies.

2. Adopt a focussed Investment Philosophy

Warren Buffett's faith in a focussed investment philosophy puts him at odds with most other financial gurus, who collectively have packaged concepts to make up what is known as modern investment theory.

In essence, 'focussed investing' means choosing only a few shares which are likely to produce above average returns over the long-term. Focussed investing evolved from the insightful notion that 'less is more.'

"If you are a 'know something' investor, able to understand business economics, and can find 10-15 sensibly priced or undervalued companies that possess important long-term competitive advantage, conventional diversification makes no sense."

Warren Buffett

3. Put the bulk of your Money on only those few Shares

At an early age, Warren Buffett realised he needed to back his own judgement. As he conducted extensive research into the companies he was considering investing in, he was confident that the share price would increase in value over time. As such, he was prepared to make a large concentrated investment in only those few companies that met his disciplined formula. It is not rocket science, in that the more money invested – the greater the return. That is why the spread between the rich and poor is always widening, because the rich have more money to invest.

"If you believe the share price will increase in value, then why not have a large investment in that company."

Warren Buffett

Buffett understands that to become wealthy you need to be prepared not to just 'dip your toe in the water,' but to dive right in when a good opportunity presents itself. This is evident when he invested 40% of his total investable funds into American Express back in 1963.

4. Hold Steady during Short-term Volatility

This is the difficult bit, but this is the most important Buffett principle. It is the one principle that I believe is the reason all other investors (professionals included) cannot replicate Buffett's investment philosophy. It is the reason all other investors cannot replicate the consistent returns Buffett achieves.

If a share price falls significantly, most investors are naturally going to hesitate to buy. This hesitation is more prevalent when you are considering investing a significant amount of your money in that company. A high level of fear exists as you will have a lot of money at risk. This is because of the greater risks involved by having a concentrated investment portfolio.

If the price continues to fall, I'm sorry but you will not be holding steady watching your lifetime savings deteriorate in value. Tell those investors who bought AMP ten years ago, or those investors who bought Telstra in the second instalment, to hold steady – "Don't worry, it is a short-term correction, you'll be right in the long run mate." Now ten years later, for both companies the price is still almost 50% less than their original purchase price. Let alone those investors in HIH, Onetel or more recently RAMS, MFS, Centro, Allco and ABC Learning.

This is the reason Buffett stands out from the crowd, even in a world where once someone is successful, soon they are copied by the masses. This is no more evident than in the world of investing and finance. Yet very few have the patience, discipline and confidence to emulate Buffett. No other investor has ever achieved the consistent returns year-in year-out that Buffett has, even though his investment philosophy has been common knowledge for decades.

The reason why others continually fail to achieve the consistent high returns Warren Buffett has is a question of emotional investing versus discipline.

These days, Buffett need not worry about stock specific risk. Nowadays, he usually buys entire companies for $10 billion, changes management, amends the company balance sheet and soon profit increases. In turn, so does the share price.

So Buffett can afford to make a concentrated investment in only a few companies, as he controls the underlying decisions of the companies he invests in. For us mere mortals, unfortunately we cannot control these decisions. Frankly, Buffett is a genius in the area of capital structure.

We need to come up with another risk reduction strategy.

For most, this risk reduction strategy is diversification. However, as you will learn in Chapter 6, the cost of diversification is that it reduces returns. To achieve the "Holy Grail" when it comes to investing, we need to discover another alternative. We need to discover another risk reduction strategy that limits our losses if the share price falls, while also giving you access to the potential to enjoy high capital growth. In doing so, the investment strategy must give you the confidence to adopt a *focussed* investment philosophy. It must also be something that eliminates the short-term emotional demons of fear and greed. Then the investment philosophy will be the perfect investment.

Chapter Summary:-

- In life, there is no need to reinvent the wheel. You look at who are the absolute best at what they do and then adopt their approach and philosophies. When it comes to investing, this person is Warren Buffett.
- A $10,000 investment in Berkshire Hathaway back in 1965 would now be worth almost $100 million.
- Warren Buffett is the world's richest man and most successful investor.
- Warren Buffett's investment philosophy:-
  1. Buy Outstanding Companies
  2. Adopt a focussed Investment Philosophy.
  3. Put the bulk of your funds into only those few companies.
  4. Hold steady during adverse market movements.

- The reason Warren Buffett achieves such consistent returns is because he never deviates from his investment philosophy, he understands the concept of compounding, and he can invest without emotion.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

Chapter Five

Emotional Investing vs Discipline

"An investor has to guard against many things, but most of all against himself."

Warren Buffett

Buy Low – Sell High. This is easier said than done – few people actually do this. It is connected to the issue of emotion versus discipline.

Historically, we know that lows in the market are made when there are more sellers than there are buyers, and highs are made when you have more buyers than sellers. Demand and supply dictate price of most commodities – whether that be gold, oil, a property or in this case, a share of a company. For price to increase there must be more buyers than sellers. For the share price to increase, demand must be greater than supply.

"The future is never clear, the world pays a very high price for a cheery consensus. Uncertainty is actually the friend of the buyer of long term value."

Warren Buffett

Conversely, for the price to fall there must be more sellers than buyers.

By definition, most investors buy high and sell low because that is what the crowds are doing. This is what causes panic, fear and greed to control the market, resulting in extreme volatility. Investors should be buying low and selling high, but in fact they are doing the opposite.

Why is this the case for 86% of all investors?

The answer to that question is simply that most investors forget their long-term discipline. Instead, they listen to their short-term emotions. There is a frenzy when the share price is going up and greed takes over the investors' long-term discipline to stay strong and follow their initial investment plan. The greed of missing out on the quick buck is what causes investors to buy high.

"The fact that people will be full of greed, fear or folly is predictable. The sequence is not predictable"

Warren Buffett

When share prices are low, fear causes the investor to panic and again concentrate on the short-term market noise, rather than their long-term investment plan. This fear usually causes most investors to sell when prices are low.

This short-sightedness and ill-discipline creates a vicious cycle where the emotions of fear and greed dictate investment decisions. This can only ever lead to more financial pain.

"There is always something to worry about, the question is whether the market has already worried about it and the share price allowed for it."

Warren Buffett

You must be a disciplined investor and ignore short-term market noise. Forget what other people are worrying about or doing in the market.

In 1963, American Express share price crashed overnight from $65 to $35 as a scandal involving one of its top clients hit the press. Whilst the share price fell significantly, the long-term profit outlook of the company remained solid. Benjamin Graham taught Warren Buffett that when stocks of a strong company sell below their intrinsic value, you act decisively. He did just this and bought $13 million worth of shares, representing 40% of the total assets within his partnership. Over the next two years, the American Express share price tripled in value and the partnership netted over $25 million in profits.

Warren Buffett was proclaimed a genius. The question must be asked as to what set Buffett apart from other investors who all had the same opportunity to acquire American Express shares (and many similar companies since), yet failed to buy and who in truth were probably selling shares in a frenzied panic?

In 1987, share markets collapsed around the world. In the mid 1990's, we had the Asian financial crisis. In 2001, we had the terrorist attacks on 11th September. On all occasions, share markets plummeted as a direct result of short-term frenzy. In these times, only a few investors (such as Buffett) sat back rubbing their hands together waiting for outstanding opportunities similar to American Express in 1963.

At the time of writing this book, the majority of global share markets – including the Australian Share Market – have fallen over 45% in less than 12 months because of the global financial crisis. Many companies here in Australia have seen their share price hammered. Is this an outstanding buying opportunity or not? Is this the time to be a buyer or seller?

In such times, enormous opportunity exists, fortunes are made and heroes in the investment world are created – yet only a few step up to buy. Most investors, stockbrokers, financial planners and fund managers merely act like the herd. They listen to the short-term noise (which creates further *fear* and uncertainty), which soon leads to further *panic* selling, even though consciously the investor understands that this short-term *fear* contradicts their long-term rational thinking.

The last twelve months have been an extremely tough reminder to investors yet again of how unpredictable and volatile the share market can be. In these times, investors need a strong stomach and nerves of steel to confront the share market, but to be a successful investor is to buy low. Ultimately, this is exactly what it takes – courage, discipline and the ability to buy when everything appears to be at its worst.

Evidence suggests that almost 100% of the time throughout history, investors who act on emotions would be significantly better off if they had done precisely the opposite to the herd and bought instead of selling in *panic*.

"When all others are being fearful, be greedy, when all others are being greedy, be fearful."

Warren Buffett

The only investor with a psychology capable of such self-confidence to follow their conviction and act against the herd is Warren Buffett. All other investors, professionals included, are overwhelmed by their emotions which ultimately costs these investors large sums of money.

The emotions of *fear* and *greed* are the only obstacles in your way to creating huge returns and massive fortunes from the stock market. Do not mislead yourself into believing that it is anything else, such as the directors, stockbrokers, the market or poor timing. The only barrier which you must overcome to achieve financial greatness is that of yourself, and how your emotions respond to the markets in which you invest.

To make money from investing you must buy low, sell high.

"The dumbest reason in the world to buy a share is because the price is going up."

Warren Buffett

To buy low and sell high, all you need to do is the exact opposite of the crowd. To buy when prices are low, you must be a buyer when the majority are selling. Likewise to sell high, you must be selling when the majority are buying.

Of course this sounds easy, but it is almost impossible to implement as it requires you to invest without emotion.

"Successful investing is as much of a psychological challenge as it is a financial challenge."

James Siegal

In reality, the majority of investors respond to fear and greed in the short-term. This is usually dictated by the market noise, which can be exaggerated by the media. If you read the paper and the headlines state, "Share markets across the globe plummet," this is not the time to be caught up in the herd mentality and to sell. Maybe it is time to review your long-term goals and rather than panic selling along with the rest of the masses, look for great buying opportunities.

"Throughout history, people have focussed too little on the opportunities that problems present in investing."

Sir John Templeton
(the Late 95 year old billionaire investor)

The bottom-line is that if it feels good, don't buy. If it feels bad, that is the best buying opportunity.

"Opportunity is missed by most people because it is dressed in overalls and looks like work."

Thomas Edison

In theory, Buffett's disciplined investment rules sound easy, but in practice, it is impossible to invest without emotion. The emotions of fear and greed are part of every investor's psychology (Buffett excluded). These emotions are especially exaggerated when attempting to adopt a focussed approach.

Chapter Summary:-

- Buy low – sell high requires investing against the herd.
- Price is dictated by demand and supply in the short-term, but over the long-term, the key driver to price is profitability.
- Most investors buy high and sell low because their decisions are dictated by fear and greed.
- If it feels good, don't buy, if it feels bad then that is probably the best buying opportunity.
- Do not let your short-term emotions cloud your long-term discipline.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

"I *warned* him about that high-risk portfolio!"

Chapter Six

Diversification vs A Focussed Investment Philosophy

Diversification

"Wide diversification is only required when investors do not understand what they are doing"

Warren Buffett

The sole purpose behind diversification is to mitigate price volatility of an individual company's share price. That is, diversification involves buying many companies across different sectors so that if one of the companies falls in value, not all your investable funds will depreciate in value.

'Do not hold all your eggs in one basket' is a common statement aimed to explain the purpose of diversification. That is, if you were to drop the basket then all your eggs will crack.

The more shares that you have the lower the potential risk involved, according to modern investment theorists.

A Focussed Investment Philosophy

As discussed in Chapter 4, a focussed investment philosophy was developed on the notion that 'less is more.'

A focussed investment philosophy involves only buying a few companies, and investing all of your funds in those few shares.

The aim is to maximise returns.

Diversification vs A Focussed Investment Philosophy

Diversification aims to protect investors against stock risk. Or does it?

The problem with diversification is that whilst it reduces stock specific risk, diversification also reduces the potential return. Looking at Figure 6.1, on the vertical axis is potential return (measured by profit and loss). On the horizontal axis is asset value.

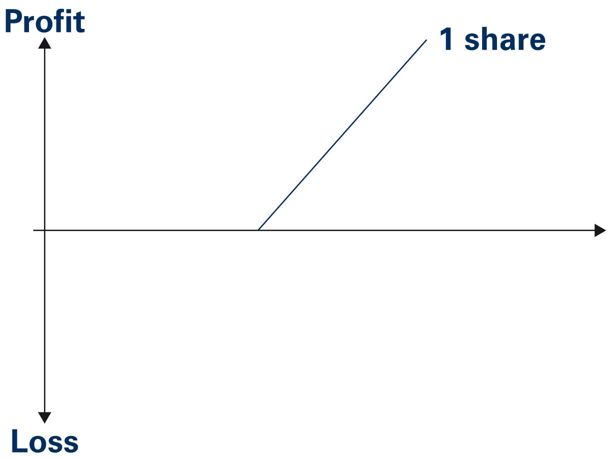


Figure 6.1 – Profit potential of holding one Share

Figure 6.1 shows the profit potential of having all of your funds investment in just one company. By owning just shares in one company you have the opportunity to make large profits.

However, by investing in one company, you are also exposing yourself to maximum potential loss if that company goes completely broke as the risk of losing a significant amount of your funds is very high.

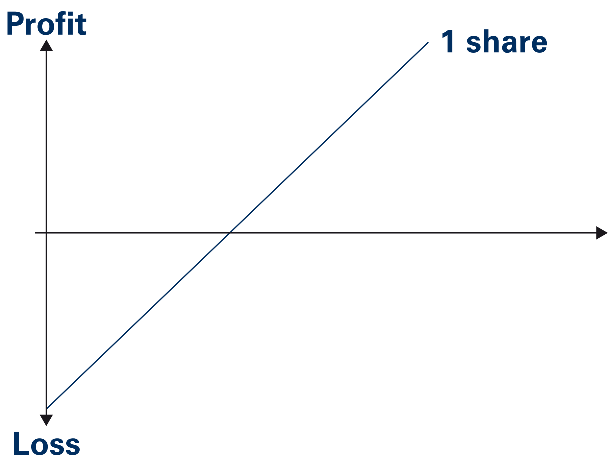


Figure 6.2 – Potential payoff from owning one Share

You can see from Figure 6.2, if we adopt a focussed investment philosophy and buy shares in only one company, we are exposing ourselves to maximum potential loss if that company goes completely broke.

The theory of diversification is, rather than buying shares in just one company, buy shares in several companies (i.e. 100) so that the impact of one company going completely broke on your overall portfolio returns is minimised. Figure 6.3 shows diversification versus a focussed investment philosophy.

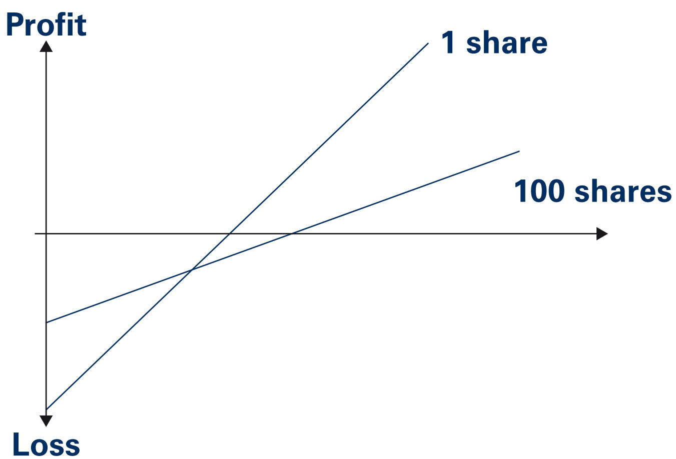


Figure 6.3 – 1 Share vs 100 Shares

From Figure 6.3 we can see that by having diversification with shares in 100 different companies, our potential loss is reduced. However, the risk/return equation is like a pendulum. Although our maximum loss is reduced with diversification, so too is our maximum potential return. We have reduced our risk, but we have also reduced our capital growth potential. Isn't diversification diluting the reason why we invested in the share market in the first place? Remember the main reason most investors look to the share market is because of the high capital gains potential. That is, we want to make as much money as possible.

Another problem with conventional diversification is that it greatly increases the chances that you will buy a company that you do not know enough about. Buffett has always said that he prefers only a small number of outstanding companies that he understands intimately, rather than a large number of average companies many of which he understands poorly.

Diversification also only reduces stock specific risk. This is only one of the three risk factors affecting the share market as described in Chapter 2. International risk and market risk still exists when you implement diversification, irrespective of the amount of shares held. This market and international risk has the capacity to significantly influence share markets across the globe, as seen over the past 12 months with the global credit crisis. In this time, the All Ordinaries Index representing the largest 500 companies on the Australian share market has declined by over 50%. I would suggest 500 shares is a well-diversified portfolio yet the Index has halved. So it can be concluded, diversification clearly fails in its attempt reduce risk.

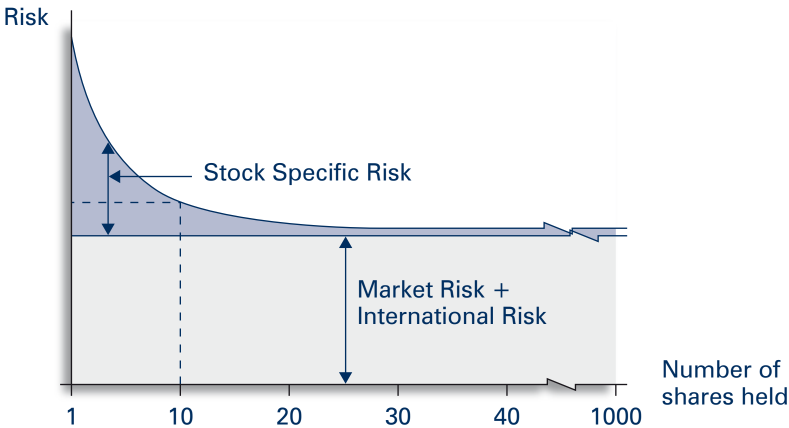


Figure 6.4 – Diversifiable and non diversifiable risk

You will recall that the "Holy Grail" when it comes to investing is to have maximum return with minimum risk. This would be a perfect investment. To achieve the "Holy Grail" or the perfect investment, the investor needs to eliminate all three risk factors influencing share investments.

To look at this on a chart, we would have the upside potential of owning only a few companies with minimal downside risk. See Figure 6.5.

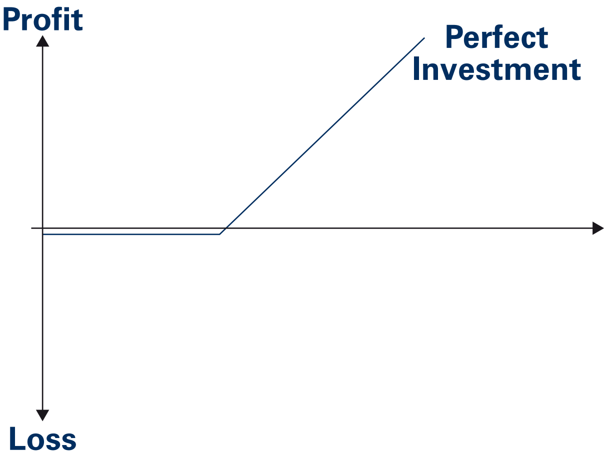


Figure 6.5 – The JB Way Risk/Return payoff diagram

If we can eliminate the risks associated with adopting a focussed investment philosophy, we no longer need to use diversification. This would mean that we can chase maximum returns to significantly outperform a diversified approach, without the usual high risks associated with making large concentrated investments.

"Diversification is merely a protection against ignorance"

Warren Buffett

Chapter Summary:-

- Diversification is often referred to as 'do not put all your eggs in one basket.'
- Diversification reduces stock specific risk, but it also reduces return.
- A focussed investment philosophy involves only buying a few companies you know really well and investing all your money in only those few companies.

- A focussed investment philosophy involves high risk, but also has the potential for high returns.
- Warren Buffett's focussed investment philosophy only works as he controls company decisions. As such, he can afford to make large concentrated investments.
- To adopt a focussed investment philosophy, we need to discover another risk reduction strategy to achieve both elements of the "Holy Grail" or the perfect investment. That is to maximise returns and minimise risk.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

Chapter Seven

The JB Way Maximum Returns and Minimum Risk

"There seems to be some perverse human characteristic that likes to make easy things difficult."

Warren Buffett

The aim of *The JB Way* is to maximise returns and to minimum risk. If we can achieve both high returns and minimum risk simultaneously, we would have discovered the "Holy Grail" when it comes to investing, or the perfect investment. This would be the solution and the investment strategy many investors, stockbrokers, financial planners, and fund managers have spent their entire career searching for. *The JB Way* is the perfect investment.

To recap, the "Holy Grail" or the perfect investment would look like Figure 7.1. An investment that offers the high returns capable from adopting a focussed investment philosophy like Warren Buffett, yet with minimum risk.

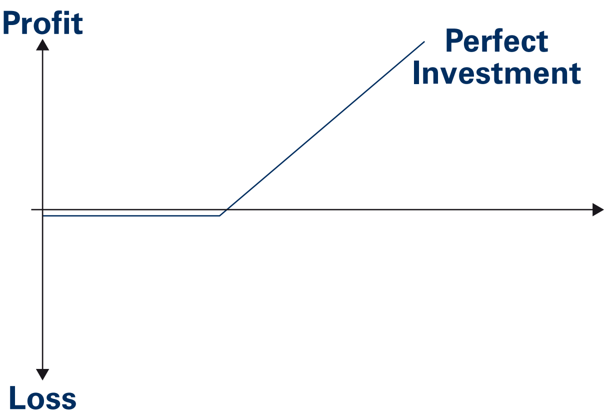


Figure 7.1 – The Perfect Investment payoff diagram

So how do we achieve high returns whilst still minimising risk?

Maximising Returns

The JB Way involves firstly maximising returns. To maximise returns, we must follow Warren Buffett, who has consistently made spectacular returns because he does not believe in diversification and adopts a focussed investment philosophy.

The first step of *The JB Way* is therefore:-

1. Adopt a focussed investment philosophy.

As discussed in Chapter 6, focussed investing means choosing only a few companies that are likely to produce above average returns over the long haul – remember, 'less is more.'

A focussed investment should consist of no more than five and no less than three different companies, irrespective of the investment amount. This requires discipline and patience to wait for outstanding opportunities. The three to five companies should generally operate in different sectors within the market (e.g. retailers, banks, resources and the like).

By adopting such a concentrated portfolio, we aim to maximise returns.

The second step of *The JB Way* again comes from merely copying Warren Buffett:-

2. Invest the bulk of your money in those few companies

"If you believe the share price will increase in value then why not have a large investment in that company."

Warren Buffett

Once you have found three to five companies you must be prepared not just to dip your toe in the water, but to dive right in. This involves investing all of your funds into those few companies.

By placing all of your funds into those few companies, if you are right and the share price increases significantly, by having a large chunk of your funds in that company, your returns are going to be maximised – similar to Buffett and his investment in American Express back in 1963.

As mentioned within the previous Chapters, Warren Buffett's investment philosophy has been common knowledge for almost 50 years, so these first two steps aimed to maximise returns have been known for half a Century.

Why novice and professional investors fail to follow Buffett's focussed investment philosophy is usually because of the high risks involved.

As Buffett generally controls the underlying decisions of the companies he invests in, he can afford to make large concentrated investments. Unfortunately, unless you have a few billion to invest you cannot control these decisions. We therefore need to come up with another risk reduction strategy.

For most, this risk reduction strategy is diversification, but we now know that the cost of diversification is that it reduces returns. To achieve the "Holy Grail" of investing or to achieve both elements of the perfect investment, we need to discover another alternative. We need to discover another risk reduction strategy that limits our losses if the share price falls, whilst also giving you access to the potential to enjoy high capital growth. In doing so, the investment strategy must give you the confidence to adopt a focussed investment philosophy. The strategy must also be an investment philosophy that eliminates the short-term emotional demons of fear and greed usually associated with such a concentrated investment.

So how do we minimise risk?

The answer to the question is very simple:-

Minimising Risk

You have probably been taught how to minimise risk since you were a teenager by your parents. Your parents, like mine, have been following this risk reduction strategy for generations.

When you bought your first car I am sure, like my mum, you were told by your parents to "...never drive your car without insurance."

We insure our car to reduce the risk or to minimise the financial loss if we crash the car.

Insurance is simply a tool to allocate risk. When you take out (buy) insurance you are paying someone else to take the risk of the asset value diminishing.

So the third step of *The JB Way* is simply:-

3. Buy Insurance on your Shares

Most of us are comfortable with the concept of insurance. To recap, let's look at why we insure a car.

Car Insurance

Assume we buy a new car for $30,000. Usually, the first thing that we do before we drive the car is make sure that it is insured.

We insure our car because if we have a crash, we do not want to pay another $30,000 to replace the vehicle.

When insuring your car, you will need to agree to a few things with the insurer before your insurance policy is put into place. These things include:-

1. The agreed value of the car
2. The cost of the insurance – this is called the premium
3. The timeframe of your insurance
4. And, if you crash the car, you also need to pay an amount called an excess

Example – Insuring your car
Purchase price = $30,000
Insurance Premium = $1,000
Excess = $500
Insurance period= 12 months
Agreed Value = $30,000

Under the above example, if you crash your car the maximum amount that you can lose is the cost of the premium ($1,000), plus the excess ($500). Therefore the maximum amount at risk is $1,500.

What does this tell us about your risk tolerance? If the maximum amount that you are prepared to lose is $1,500, and you didn't have insurance on your vehicle, you would be driving a car worth only $1,500. However, by having insurance it gives you the comfort to drive a car worth $30,000 with the same personal risk of $1,500. Having insurance transfers the risk from the car owner to the insurance company.

In this example, the maximum amount you can lose is 5% of the value of your car.

What fascinates me though is that most cars do not increase in value. That makes a car a liability.

Yet most of us will insure our liabilities but not our assets or our lifetime savings which we have worked so hard for to save and accumulate.

There are more crashes on the share market each year than you are likely to experience in a lifetime of driving your car. So, is it not more important to have insurance on your investments whether that investment is held in your own name or in your Superannuation Fund?

Most of us would not think to insure our shares. Why is this the case? Perhaps most of us do not know that we can insure our shares.

Insurance on Shares

So how do we insure our shares?

You can insure your shares through what is called a "put option."

A put option gives you the right to sell your shares for the agreed value (called strike price) at any time up to the expiry date. Simply, a put option is an insurance contract and you pay a premium for someone else to take the downside risk if the share price falls. There is no excess provided, the strike price of the put option equals the purchase price of the shares.

With a put option, if the value of your shares falls, then you can make a claim on the insurance policy for the difference. That is, the insurance company pays you the protected value of your shares.

The share market itself can be very simple.

A share price can do one of three things – it can go up, go down or stay the same.

If the share price falls, we use our insurance policy to sell those shares at the price paid and the loss is limited to the premium paid for the put option.

If the share price stays the same, we can sell our shares at the protected price or buy further insurance to extend the protected period. In both scenarios, the maximum loss is capped at the premium paid.

If the share price goes up you make money. You receive all the upside profit potential from owning shares.

Example

You purchase 1,000 shares in XYZ at $10.00. At the same time you buy 1 put option to protect the 1,000 shares with a strike price of $10.00. This gives you the right, but not the obligation to sell your 1,000 XYZ shares at $10.00 at any time up until the expiry date of the put option. In this example, let us assume that the insurance period is 12 months and let us assume that the premium paid for the put option costs $1 per share.

Remember, over the 12 months a share price can do one of three things. The share price can go up, stay the same or go down.

– What happens if the share price falls?
If the share price falls to $5.00, you can sell the 1,000 shares at $10.00 by exercising your right under the put option contract. That is, you make a claim on the insurance policy. You are then paid by the insurance company the $10,000. The loss would be limited to $1,000 – being the premium paid for the put option (insurance policy).

– What happens if the share price stays the same?
If the share price stays the same, you can extend the protected period by buying another put option or sell your 1,000 shares at $10.00. Again the loss would be $1,000 – being the premium paid for the put option (insurance policy).

– What happens if the share price goes up?
If the share price goes up to $15.00, you have made $5.00 per share or a $5,000 capital gain. As the premium paid for the put option was $1,000 and this has now expired, your profit would be $4,000 or 40%.

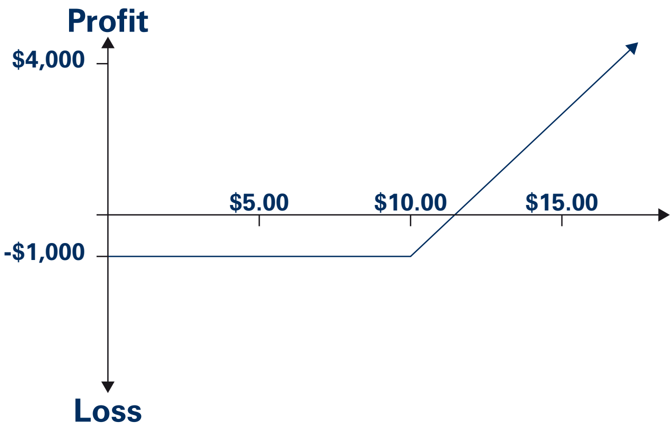


Figure 7.2 – The JB Way – risk /return payoff diagram

This is a very simple example, but *The JB Way* is not that complicated. You have been buying insurance on your car probably since you were 17 years old because this is what your parents taught you. My mum always reminded me to, "Never drive your car without insurance." You now need to just apply that same philosophy to your investments.

The JB Way is simple, safe and successful.

"The business school rewards difficult complex behaviour more than simple behaviour, but simple behaviour is more effective"

Warren Buffett

By buying insurance, we are transferring a significant amount of the risk of owning shares to the insurance provider. The maximum risk is the premium paid for the insurance, provided you insure the shares at the purchase price. That is, the strike price of the put option equals your purchase price.

The major risk for *The JB Way* is the premium paid for the insurance.

For an investment to be completely perfect though, it would be nice to receive some income throughout the protected period to reduce this risk even further.

The fourth step of *The JB Way* and the second component aimed to minimise risk is:-

4. Use the dividend income to offset some of the premium paid for the insurance

As a shareholder you are entitled to a few rights. Remember, the main benefit of being a shareholder is to profit from the capital growth if the share price increases. The second benefit is to share in company profits through receiving dividends. This dividend income can reduce the risk of *The JB Way* by offsetting some of the premium paid for the put option.

If the total dividend income equals the premium paid for the put option, then even if the share price was to fall, your investment loss can be limited to zero. However, whilst the dividend can reduce the cost of the insurance policy sometimes to zero, the risk is still the premium paid for the put option as future dividend income is not a certainty.

Therefore, the maximum risk faced by the investor is capped at the premium paid for the put option less any dividend income received. In the event that no dividend is paid, the maximum loss is the premium paid for the put option.

The Risks

The risk is capped at the premium paid for the put option contract.

The aforementioned examples do not include brokerage or transaction costs. But this doesn't matter because at JB Global Investment Services, we do not charge brokerage!

The examples also do not take into consideration tax, as each individual has different tax implications. You should consult your accountant prior to investing about the tax consequences of *The JB Way* for your specific circumstances.

Other Important Facts

The put option or insurance policy is guaranteed by the Australian Stock Exchange (ASX) through a process called "novation."

Novation is the process whereby the Australian Clearing House (a subsidiary of the ASX) becomes the counter-party to both the buyer and seller of an option contract. This means that the counter-party to pay the insured amount, under the obligations of the put option contract, lies with the ASX.

Another important factor that needs to be highlighted is that whilst the ASX is the counter-party to your put option, it also has the capacity to adjust the strike price (protected price) of your put option contract. The only reason that the ASX can make such adjustments is if a corporate event occurs, such as a special dividend or a rights issue. While the adjustment might affect your protected price, the aim is to ensure the holder of the put option is not placed at a disadvantage in these circumstances.

Investors can also choose to buy out of the money put options which will be somewhat cheaper. That is, the premium would be less than the "at the money" put option. This is similar to accepting a higher excess payment with insurance on your motor vehicle. When the excess is higher, the premium is lower, although the savings might not be that significant as you are exposed to greater risk if the share price falls. This is very similar to being self-insured for a portion of your investment.

The JB Way involves buying put options with a strike price either equal to, or very close to the purchase price of the underlying shares.

The cost for the put option can be higher or lower than what has been used in my examples. The premium for the put option is influenced by the underlying company, the volatility of the share price, dividends and liquidity.

Let's look at some examples to see how this works:-

Example – Westpac

Westpac (WBC) – 1st September 2005	
Purchased 2,000 shares at $19.50	$39,000
Purchased two WBC put options expiring in June 2006 with a strike price of $19.50	$2,300
Total Outlay	**$41,300**

By combining a share investment in WBC with insurance via put options, the investor reduced their downside risk on their $39,000 investment to only $2,300. This $2,300 was the premium paid for the put options.

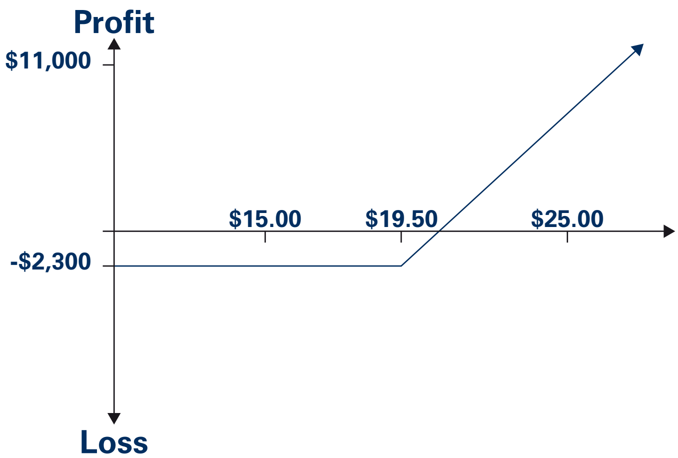


Figure 7.3 – WBC payoff diagram when applying The JB Way

WBC paid a total dividend of $1.52 or $3,040 for the 2,000 shares held. If the share price fell below $19.50 per share at the expiry of the put options held, the investor would still make a profit of $740. This is due to the fact that the total dividend income was higher than the cost of the put option premium. Furthermore, the investor receives all of the upside capital growth potential if the WBC share price increases in value above $19.50.

Prior to the expiry of the put option, the WBC share price traded at $25.00.

At $25 per share, when we include both the cost of the put option and the total dividend income received, the investor has made a profit of $11,740 or 28.4% over the eight month period.

Remember, the maximum the investor could lose was $2,300 or 5.6% of their total investment.

With *The JB Way*, you enjoy all the pleasure associated with making money if the share price rises in value, whilst being protected from the pain associated with losing a lot of money if the share price falls.

Example – AMP

AMP – 7th July 2005	
Purchased 5,000 shares at $6.50	$32,500
Purchased five AMP put options expiring in March 2006 with a strike price of $6.50	$2,575
Total Outlay	**$35,075**

By combining a share investment in AMP with insurance via put options, the investor has reduced the downside risk on $32,500 worth of AMP shares to $2,575. This $2,575 was the premium paid for the put options.

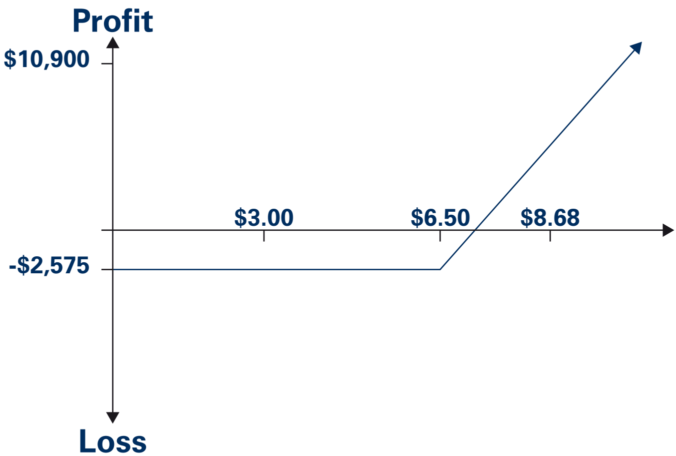


Figure 7.4 – AMP payoff diagram when applying The JB Way

AMP paid a total dividend of $0.423 per share or $2,115 for the 5,000 shares held. The loss if the share price fell (after we include the total dividend benefit) would be $460. That is, even if the AMP share price fell to $1.00 per share (a fall of 85%) your loss would be limited to only 1.3% because of the fact that the dividend income has offset almost the entire premium paid for the put option contract.

Prior to the expiry of the put options, the AMP share price traded at $8.68 – an increase of 33.5%.

At $8.68 per share, the investor made $10,440 profit with a maximum risk of $2,575. This is a return of almost 30% on the initial investment with very little risk.

Note, AMP paid a special dividend during the holding period. Under such circumstances, the ASX has the capacity to change the specifications of the put option contract to ensure both the buyer and seller of the option is not disadvantaged by such corporate activity. The strike price of the put option was reduced to $6.36 and the number of shares per contract size was increased to 1,039. As the special dividend paid was $0.40, these adjustments did not have a negative impact on the risk of the investment. As the share price at maturity of the put option contract was above the strike price, the investors profit was $2,000 higher because of the special dividend.

Example – Bluescope Steel

Bluescope Steel (BSL) – 19th September 2005	
Purchased 4,000 shares at $10.00	$40,000
Purchased four BSL put options expiring in September 2006 with a strike price of $10.00	$3,920
Total Outlay	**$43,920**

By combining a share investment in BSL with insurance via put options, the investor has reduced the downside risk on $40,000 worth of BSL shares to $3,920. This $3,920 was the premium paid for the put option contract.

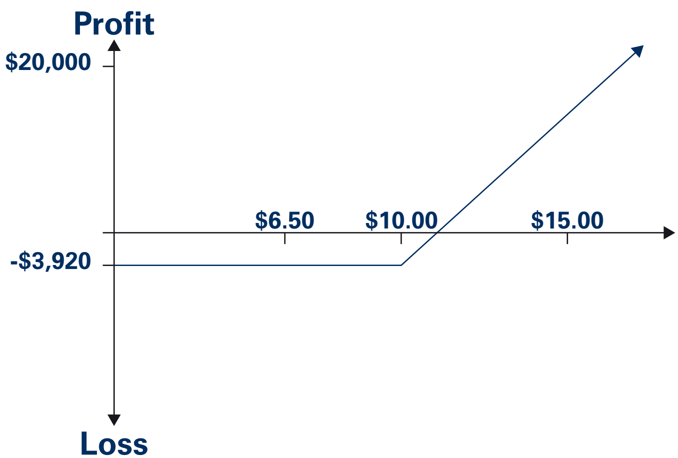


Figure 7.5 – BSL payoff diagram when applying The JB Way

BSL paid a total dividend of $0.914 per share (or $3,656 for the 4,000 shares held). The loss if the share price fell would be reduced to $264 by this dividend income.

That is, the investor receives all of the upside capital growth potential if the BSL share price increases in value above $10.00, but if the share price fell in value, the loss will be limited to $264. Therefore, the investor enjoys all the upside profit potential without all the usual downside risk if the share price falls.

Prior to the expiry of the put options, the BSL share price fell to below $6.50, a fall of over 35%.

At $6.50, if the investor did not have the put options, they would have lost $14,000 or 35%, but by exercising the put options, the investor's loss was limited to only $264 or less than 1%. The investor exercised their right to sell the 4,000 BSL shares at the protected price of $10.00. The investor was then paid the $40,000 by the ASX. They lost the $3,920 paid for the put options, but as BSL's total dividend benefit was $3,656 throughout the holding period, the total loss was $264.

$40,000 + $3,656 – $3,920 = $39,736 or a $264 loss

The loss is less than 1% even though the share price has fallen 35%! This is why we insure our shares!

By buying insurance, you can protect your lifetime savings from a share price decline!

Remember Warren Buffett's rules to investing:-

Rule Number 1: Never Lose Money

Rule Number 2: Never forget Rule Number 1

Has *The JB Way* proved modern investment theory wrong? That is, under *The JB Way* can the investor achieve high returns whilst only being exposed to minimum risk?

All of the above examples indicate the answer to this question is, "YES!"

The JB Way suggests modern investment theory is outdated and completely wrong.

The JB Way is an investment strategy that offers high potential returns with minimum risk. Whilst an investor's downside risk has not been entirely reduced to zero, we have significantly reduced the risk to be capped at the premium paid for the put options.

Having insurance also gives you the peace of mind to invest for the long-term, without having your investment decisions clouded by short-term emotions resulting from the fear associated with the possibility of losing a lot of money. Therefore, you can comfortably make a large concentrated investment to ensure returns are maximised similar to Warren Buffett.

In these examples, I have not included any transaction costs, brokerage, management fees or tax. These variables will depend on whether you employ a discount or full service stockbroker to implement the investment philosophy, likewise depends on your personal tax situation. When these costs are included, the results will be less depending on the service employed.

The JB Way

1. Adopt focussed investment philosophy to ensure returns are maximised;
2. Put the bulk of your money on those shares;
3. Buy insurance;
4. Use the dividend to offset some of the insurance premium.

To this I must add the important ingredient of YOU. You must never forget that to be a successful investor, you must be a disciplined long-term investor. This involves sticking to your plan, sacrifice and patience.

When you make money, *NEVER* forget your strategy of buying insurance. Just because you didn't need your car insurance last year does this mean you will not insure your car for the next 12 months? Of course not! It is easy to become over-confident and to deviate from your investment plan. When this occurs and greed dominates your decisions, you will lose money, so always remember to insure your shares.

When the market falls and everything appears to be crashing around you, firstly, thank your lucky stars you bought insurance. Secondly, again do not deviate from your plan. Remember, the share market over the long run has historically outperformed all other asset classes. Ask yourself, why are you fearful? As you have insurance, the loss can be a very small portion of the amount invested. So rather than hitting the "sell" button in a frenzied panic, ask yourself – what opportunities now exist?

Have we discovered the "Holy Grail" to investing? Is this the investment you have been searching for? An investment that offers all the upside profit potential from the share market but without all the usual risks.

Is *The JB Way* the perfect investment?

Chapter Summary:-

- Insurance involves transferring the downside risk from the investor to the insurance company.
- The cost for the insurance is called a premium.
- A put option is an insurance policy for shares, as it gives the holder the right but not the obligation to sell the underlying shares at an agreed price on or before the expiry date.
- The downside risk is limited to the premium paid for the put option, which can be reduced depending on the dividend income.
- The insurance policy or put option is guaranteed by the ASX.
- The investor receives all the capital growth potential capable from the share market, yet the majority of the usual risks have been eliminated.
- The investor can make a large concentrated investment without the usual fear associated with the increased risk of 'putting all your eggs in one basket.' In turn, this should provide a higher return, similar to those returns achieved by Warren Buffett.
- *The JB Way* is the perfect investment as it has maximum profit potential capable from adopting a focussed investment philosophy, like those returns consistently achieved by Warren Buffett, yet has very low risk because of the insurance.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

How to Construct a Focussed Investment Portfolio

The JB Way involves adopting a focussed investment philosophy in an attempt to provide high potential returns similar to those achieved by Warren Buffett.

A focussed investment should consist of no more than five and no less than three different companies, irrespective of the investment amount. This requires discipline, confidence and patience to wait for outstanding opportunities consistent with the first step of the Warren Buffett philosophy – buy outstanding companies.

By adopting *The JB Way*, the investor can afford to pick volatile shares as you will always have insurance in place, so you are somewhat protected if the share price of one of those companies falls. Irrespective of the size of the share price fall, the loss will be capped at the premium paid for the insurance, less any dividend income received.

The three to five companies should generally operate in different sectors within the market (i.e. retailers, banks, resources and the like). By having shares in companies that come from different sectors, you significantly improve your chances of making money. This is because if you own shares in a company and own insurance over those shares, the impact on the overall portfolio performance is limited if the price falls. An out-performer is always going to contribute more to your overall performance than an under-performer as you have all the upside profit potential from the share price that increases in value, whilst you have limited your loss on the share price that falls in value.

Example

Let's compare the different returns from the two investment strategies. One portfolio has followed *The JB Way* and the other is the traditional buy and hold strategy.

Let's assume both portfolios comprise of the same four companies from four different sectors, you have $100,000 invested in total ($25,000 in each company) and that the dividend income covers the premium paid for the put option contacts. This is rarely the case, but for simplicity reasons we will make the assumption in this hypothetical example only.

The results:-

The first company's share price increases by 50%, the second company's share price falls by 50%, the third company's share price rises 30%, and the final company's share price declines by 30%. See Figure 8.1.

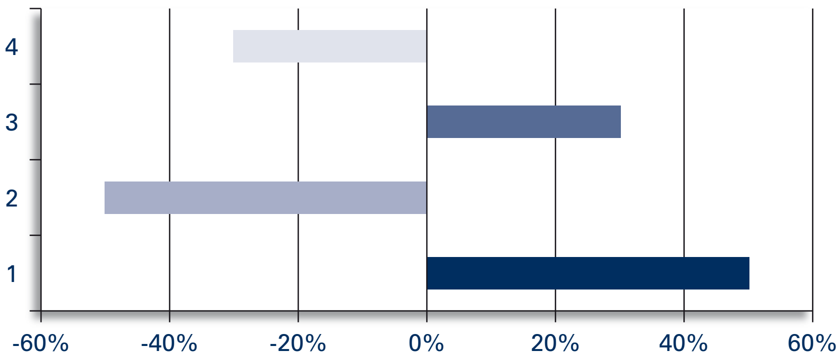


Figure 8.1 – Buy / Hold portfolio returns

Under the traditional buy/hold strategy, the capital gain is zero. The gains from Company 1 and 3 are offset by the losses from Company 2 and 4.

For the same portfolio under *The JB Way*, you enjoy all the benefits of the shares that appreciate whilst limiting your losses to zero for the stocks that depreciate. That is, with *The JB Way* you keep Company 1 and 3 and sell Company 2 and 4 at the price paid. Company 1 – you make 50%; Company 2 – loss is zero; Company 3 – you make 30%; and Company 4 – your loss is zero. See Figure 8.2.

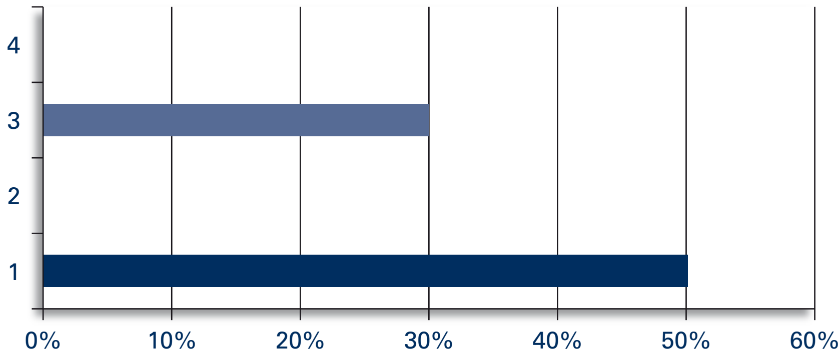


Figure 8.2 – The JB Way portfolio returns

Following *The JB Way*, as you have equal weighting in each share, the total capital gain is 20% instead of merely breaking even under the traditional buy and hold strategy. The difference or significant out-performance is because you have insurance on each individual share and can sell the under-performing shares at the price paid, irrespective of the share price decline.

The JB Way involves lower risk than the traditional buy/hold strategy as you have insurance, yet the up-side profit potential can be significantly higher by targeting growth stocks and by limiting any loss for the shares that fall in price.

Keep the good companies and sell the bad performers at the price you paid for them!

"Should you find yourself in a chronically leaking boat,
energy devoted to changing vessels
is likely to be more productive than fixing leaks."

Warren Buffett

Remember, we have assumed in this example that the dividend income covers the premium paid for the put option. This is not always the case and might impact on the results.

Case Study – Peter and Ann

Initially, Peter and Ann were not comfortable investing in the share market as they thought the risks were too great. However, by using insurance through put options on their share investment, Peter and Ann realised that the total risk of making such an investment was significantly reduced.

By having insurance, Peter and Ann had greater comfort to invest a significant portion of their money in the share market.

Step 1

In line with *The JB Way*, Peter and Ann adopted a focussed investment philosophy similar to Warren Buffett in the pursuit to maximise returns. That is, they invested in three companies from three different sectors – WBC, BSL and AMP.

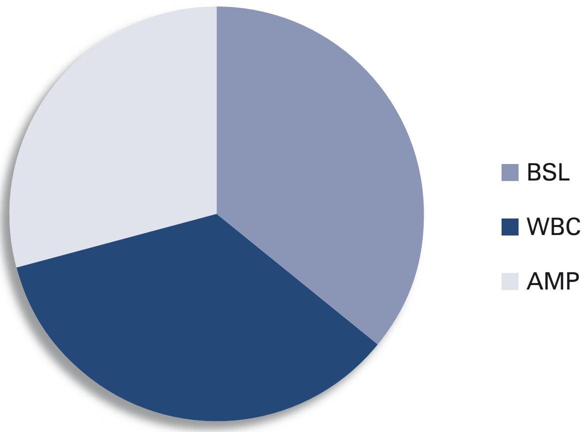


Figure 8.3 – Portfolio Allocation

As shown in Figure 8.3, Peter and Ann had approximately equal weighting in each company. The companies operate in different sectors therefore the risk of all three share prices falling at the same time should be less, thereby increasing the chances of making money. Different sectors of the economy often operate in different cycles meaning AMP and WBC could both increase while BSL falls, which is exactly what happened. If you owned three steel companies, there is a high chance all three companies share price would have declined in value over the holding period.

Step 2
Put the bulk of your money into those few companies. Peter and Ann had a total of $111,500 invested across all three companies.

Step 3
Peter and Ann purchased put options on each company to reduce risk.

Step 4
Over the course of the protected period, Peter and Ann used the dividend income to reduce the premium paid for the put options.

If Peter and Ann made the same investment following the traditional buy/hold and pray approach to investing on the share market, the risks would be significant. The actual performance of the three companies is shown below in Figure 8.4.

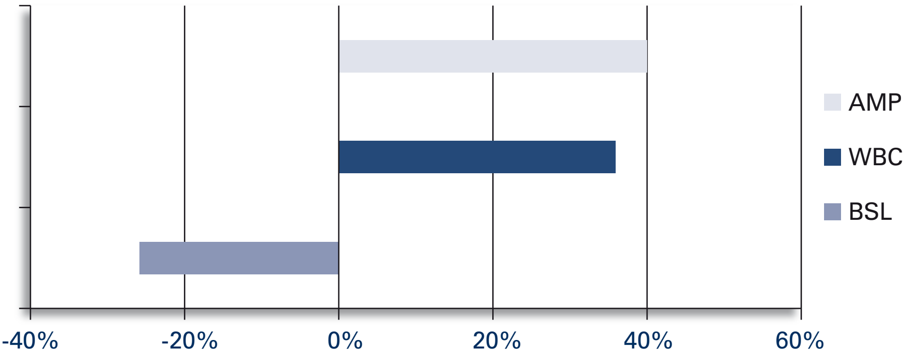


Figure 8.4 – Returns under the traditional approach to investing

If Peter and Ann had investments across the same three companies without insurance, they would have made a total profit of $16,310 or a return of 14.6%. The risk of such an investment would be huge, because if one company falls in price, a significant amount of capital would be lost as a result. Given Peter and Ann are conservative investors and initially were not comfortable investing in the share market because of the high risk involved, such a focussed investment without insurance could never meet their needs. They could never adopt such a focussed investment in the pursuit to maximise returns as the risk involved are too great.

As Peter and Ann have worked hard to accumulate their wealth, they do not want to risk losing their life-time savings.

The JB Way gave Peter and Ann the certainty they were after. By having insurance on their shares, Peter and Ann could comfortably adopt the proven focussed investment philosophy, like Warren Buffett, to hopefully maximise returns. This combined with the peace of mind and certainty that if all three companies did fall, their entire investment would not be eroded.

They understand that by having insurance, their risk is significantly less than the traditional buy and hold philosophy.

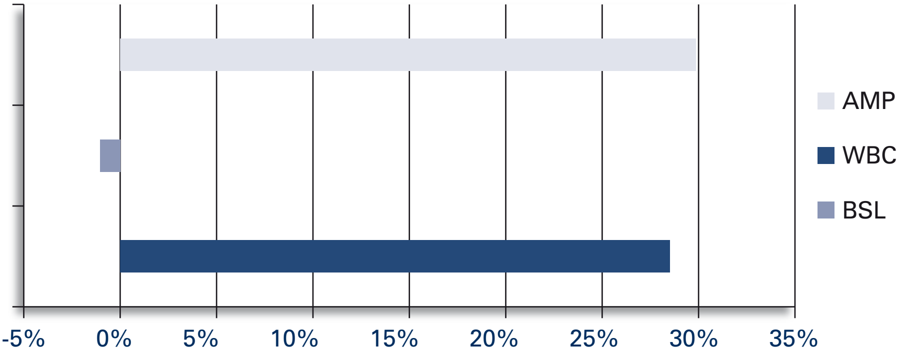


Figure 8.5 – Returns under The JB Way

Peter and Ann made 28.4% on WBC and 29.7% on AMP. The BSL share price fell 35%, but by having insurance through the put options, Peter and Ann could sell their BSL shares at the purchase price, thereby reducing the loss for BSL to less than 1%.

Therefore, the total portfolio return Peter and Ann made was $21,900 or 19.64%.

The maximum risk of *The JB Way* is the premium paid for the put option. On the entire portfolio, this risk was $8,795 or less than 8%. This assumes all three companies go completely broke and do not pay any dividends. As the three companies operate in different sectors, the probability of all three not paying a dividend at all is extremely low.

The total dividends paid over the three companies for the initial protected period was $8,810. Therefore, after dividends, if all three company's share price fell in value below the protected price, Peter and Ann would actually make money – albeit a small amount, being $15. If the share prices increased, Peter and Ann would make all the upside profit potential.

The usual risks of the share market have been significantly reduced under *The JB Way* as Peter and Ann own insurance. As the risks are significantly less than buying shares without protection, then according to modern investment theory, returns should be less. After all, modern investment theorists suggest returns are correlated to risk. However, Peter and Ann made 19.64% under *The JB Way*, where if they did not have protection even with the same portfolio their return would be only 14.6%.

Has *The JB Way* once again proved modern investment theory wrong? Has *The JB Way* outperformed both on a return and risk basis? Is *The JB Way* the perfect investment?

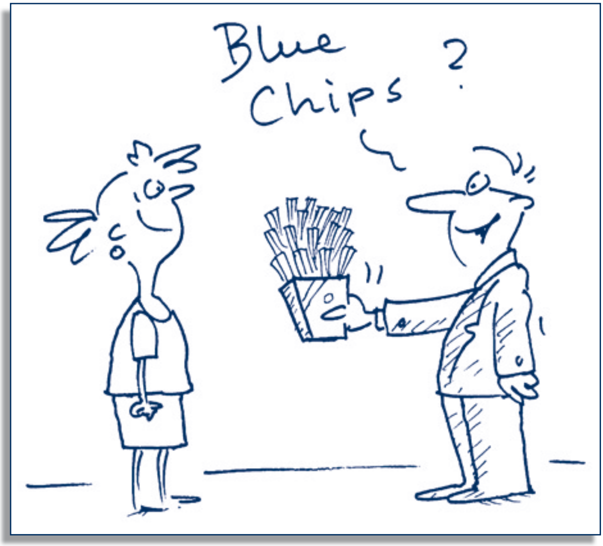
The answer to these questions is YES! You do not need to take on huge risks to make high returns.

We have maximised returns whilst minimised risk.

The JB Way is simple, safe and successful.

Chapter Summary:-

- A focussed investment philosophy implies buying no more than five (5) different companies and no less than three (3).
- Ensure those companies operate in different sectors.
- The aim is to purchase the best value company within the chosen sector.
- Having insurance ensures that those companies which fall in value do not erode all of the profits received from those shares that appreciate in value.
- Insurance gives the investor comfort to have large concentrated investments in only a few companies.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.


Blue Chips ?

Active Management

"Volatility is merely the transfer of wealth from the impatient to the patient"

– Warren Buffett

What is Active Management?

Firstly, it is important to clarify that active management should not be confused with trading. Active management merely aims to maximise returns over the long-term via only a few investment decisions for the entire holding period of the specific share. This certainly does not involve speculating.

The performance of the All Ordinaries Index, which is a measure of Australia's largest 500 listed companies, is shown below. This is for a period of 30 years from June 1978.

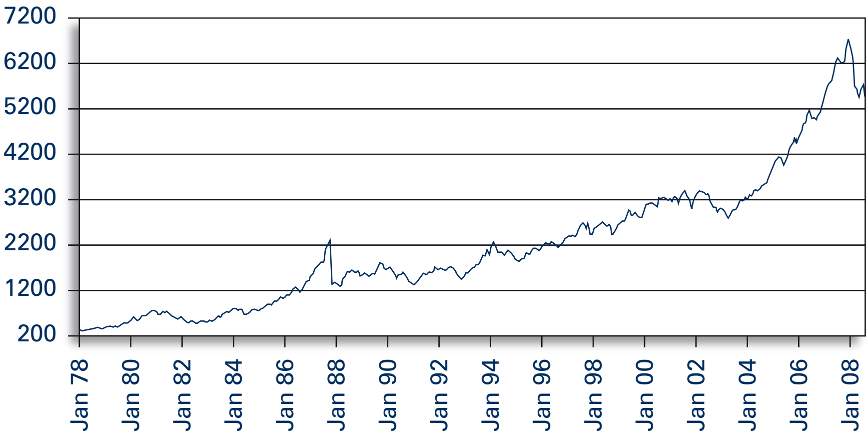


Figure 9.1 – All Ordinaries Index

As anyone who has followed the share market would know, markets do not always increase in value. The share market can go up and down on a regular basis. Although the share market has the capacity to fall in value we generally accept this, as we know that over the *long-term* there should be more years the market increases in value than years the market falls.

Whilst the market goes up and goes down, if we ignore the *short-term* fluctuations that occur daily and just look at the *long-term* trend, the share market trend is up as shown below. As can be seen from Figure 9.2, when we take an average or exclude the highs and lows, the *long-term* return of the Australian share market is approximately 14% for the past 20 years.

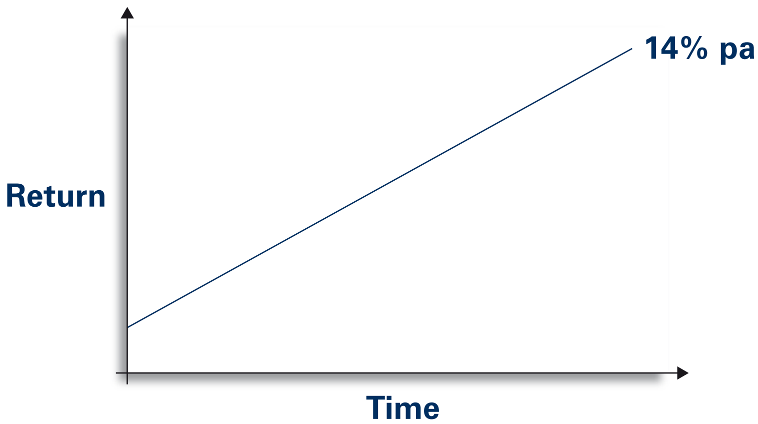


Figure 9.2 – Long-term trend of the share market

It is often said that investing in the share market is a "bumpy ride." This is because of *short-term* volatility. Whilst we often accept that over the *long-term* the market should rise, *short-term* market movements are filled with rises and falls.

The share market volatility is shown in Figure 9.3.

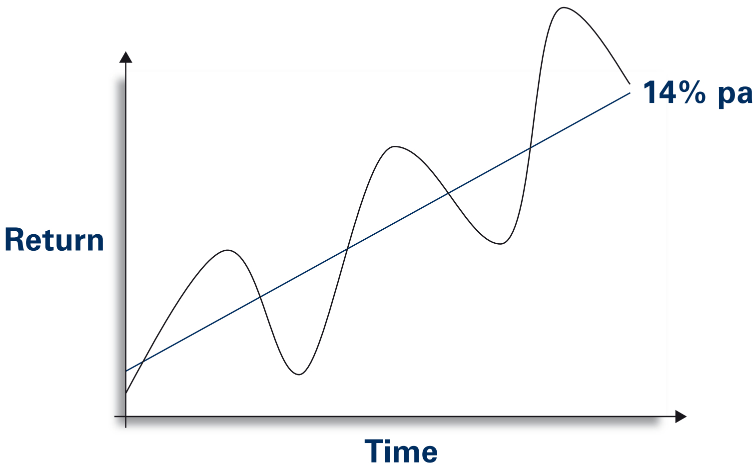


Figure 9.3 – Share market volatility

This volatility is generally dictated by the psychology of *short-term* investors, which can create outstanding buying opportunities for *long-term* patient investors in fundamentally strong companies. It is when the *short-term* frenzy that pushes share prices down that Warren Buffett can buy outstanding companies when they trade below their intrinsic value.

So how can we take advantage of *short-term* market movements, like Warren Buffett, and maximise returns when such volatility occurs?

The JB Way involves two different types of active management
1. Locking in gains;
2. Rolling down

Locking in Gains

As the share price increases so too does the risk of losing those gains. If the share price increases above the purchase price, you are at risk of having some or all your profits erode if the share price falls in value.

Let's assume the share price increases in value and at expiry of the insurance policy, the price is above that of the protected price. At this time, we are forced to make an investment decision and the choices we are faced with are:-
1. Sell the shares; or
2. Buy further insurance.

Selling shares would involve deviating from our *long-term* disciplined approach to investing, while also giving the buyer of those shares all the future capital growth potential if the share price continues to rise.

The reason most investors sell when the share price rises is because the investor is fearful of losing those gains.

The only thing worse than losing money on the share market, is seeing your profits turn into a loss.

Those investors follow the philosophy that you don't go broke making a profit. This might be the case on individual holdings, but these same investors sell their best performing shares too early and keep their losing shares too long – resulting in total portfolio declines.

If you had $10,000 invested in Berkshire Hathaway back in 1965, those shares would today be worth almost $100 million. The problem is that there is only one shareholder who has held shares in Berkshire Hathaway for that entire period, and that is Buffett himself. Most investors sold when their initial $10,000 investment had appreciated to $12,000. They were happy with a 20% return and therefore sold and invested elsewhere. These investors sold because they were fearful of losing those gains. The only way to lock in gains is to sell...or is it?

By selling the shares, the investor would also have to pay tax on the gains.

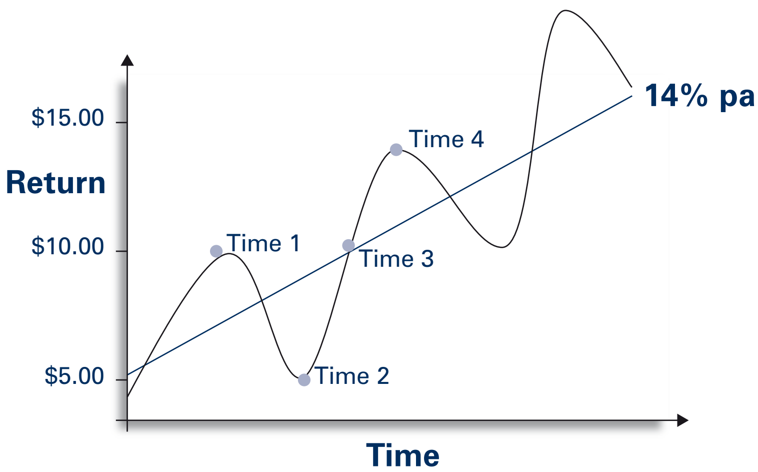


Figure 9.4 – Locking in gains

Assume we buy at "Time 2" for $5 and at expiry of the insurance the share price is trading at $10, "Time 3." As an investor, you are faced with a decision to sell your shares and make $5 profit or to lock in gains by buying further insurance. Either way, the investor will still make $5. However, by buying further insurance, you still profit from any future capital growth. The additional risk is the premium paid for the insurance. This risk could be reduced depending on future dividend income.

If the share price continues to increase to $15 at "Time 4," you make further gains. That is, your initial $5 is now worth $15. If you had sold your shares at $10, any future gains above $10 will go to the investor you sold the shares to. You would not receive any of the gains above $10 as you no longer held the shares.

In fact, if the share price fell from $10 to $5, even though the share price has depreciated to the initial purchase price, you will still make $5 profit as you have the right to sell those shares at $10 given the new protected price. If you still believe in the underlying company at this point, you could implement the roll down feature of Active Management.

There is nothing more frustrating than selling your shares too early and seeing the investor who bought the shares off you make more money than you did.

Case Study – Locking in gains

Remember that initially Peter and Ann were not comfortable investing in the share market as they were conservative investors. Usually an investment within the share market is therefore out of the question given the high risks associated. However, with insurance Peter and Ann could confidently invest in WBC shares, as the risk was significantly reduced.

Westpac (WBC) – 1st September 2005	
Purchased 2,000 shares at $19.50	$39,000
Purchased two WBC put option expiring in June 2006 with a strike price of $19.50	$2,300
Total Outlay	**$41,300**

By combining a share investment in WBC with insurance via put options, Peter and Ann were able to reduce their downside risk to only $2,300.

Prior to the expiry of the put options in June 2006, WBC share price traded at $25.00. Peter and Ann had made a capital gain of $11,000 plus the $740 difference between the dividend income and the put options expense.

As the put options contract was due to expire, Peter and Ann had to make an investment decision. They were faced with two alternatives:-

1. Sell the shares at $25.00; or
2. Buy $25.00 put options to lock in the gains and extend the protected period.

If Peter and Ann sold the shares at $25.00, they would have given away any future profit potential to the buyer. Many investors generally sell their shares too early, only to see the share price appreciate in value for years to come.

"The best holding period is forever"

Warren Buffett

By buying $25.00 put options, Peter and Ann locked in the $5.50 gain whilst they can still enjoy any future profit potential. This does involve additional funds to pay for the $25.00 put option, but Peter and Ann received $3,040 in total dividends so have cash available to pay the premium for the second put option contract.

Westpac (WBC) – June 2006 at $25.00 per share	
Purchased two WBC put options expiring in September 2007 with a strike price of $25.00	($2,940)
Total dividend received from June 06 – September 07	**$3,514**

At the expiry of the second series of the put option contract in September 2007, WBC share price was trading at $28.00 per share. Peter and Ann have now made a capital gain of $17,000 plus the $1,214 difference between the dividend income and the put option expense since the initial purchase date.

Again, Peter and Ann had to make an investment decision. They were faced with two alternatives:-

1. Sell the shares at $28.00; or
2. Buy two $28.00 put options to again lock in gains and to extend the protected period.

By buying a $28.00 put option, they are locking in the $8.50 per share gain whilst still enjoying any future profit potential.

Westpac (WBC) – September 2007 at $28.00 per share	
Purchased two WBC put options expiring in June 2008 with a strike price of $28.00	($3,580)
Total dividend received from September 07 – June 08	**$3,942**

Unfortunately over the next nine months, WBC share price fell from $28.00 back to $19.50 per share, a decrease of 30%. The share price has fallen all the way back to the initial purchase price. Usually under the traditional buy/hold scenario, investors have had all their gains wiped away. However, as Peter and Ann hold the $28.00 put options they can sell their shares at $28.00 even though the market price is $19.50. This is executed by selling their 2000 shares at $28.00 by exercising the put options held.

At this point, Peter and Ann have $56,000 from the sale of their WBC shares. If Peter and Ann still believe WBC is the best allocation of their capital, they can buy more shares at the new market price. At $19.50, Peter and Ann could buy 2,871 WBC shares.

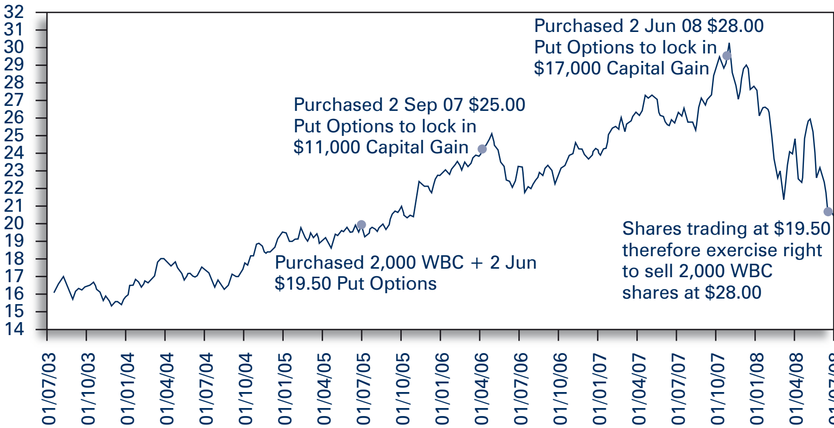


Figure 9.5 – WBC five year share price chart

As the share price falls, the investor can make shares, as the shares price increases the investor makes money.

Locking in gains gives you the added benefit of hindsight. That is, you will hopefully sell very close to the highest price, rather than wishing you had if you did not hold insurance.

Locking in gains – AMP

Initially Peter and Ann purchased 5,000 AMP shares at $6.50 and the associated $6.50 put options.

At expiry of the initial put option contract, AMP share price was trading at almost $9.00. Peter and Ann could sell their shares at $9.00 or purchase further put options to lock in those gains.

Following *The JB Way*, Peter and Ann purchased further put options with a strike price of $9.00.

At the expiry of the $9.00 put options, AMP's share price had increased to above $10.50. Again, to lock in gains and to extend the protected period, Peter and Ann purchased put options with a strike price of $10.50.

Over the next twelve months, the AMP share price plummeted along with global share markets as a result of the credit crisis. At the expiry of the put options, AMP had fallen over 40% to $6.50. Usually, most investors have had all of their gains eroded; but as Peter and Ann have the right to sell their 5,000 AMP shares at $10.50, they have the benefit of hindsight. Peter and Ann sold their shares at $10.50 by exercising their right to do so under the put option contract, making $4.00 per share or a $20,000 profit.

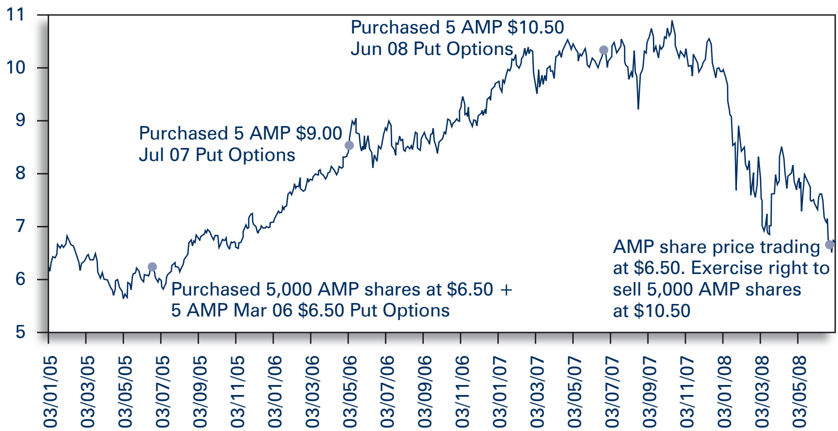


Figure 9.6 – AMP five year share price chart

"Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it."

Warren Buffett

Whether it is through rolling down your investment or locking in gains, the only guarantee in the share market is that you will own shares that rise in value and shares that will fall. Provided you can minimise losses in those that fall and maximise profits in those that rise, you will make considerable long-term wealth from the share market.

Rolling Down

Rolling down is a process that can be implemented if the share price at expiry of the insurance period is below the initial protected price. Rolling down should only be implemented if the underlying company is still considered to be the best allocation of your capital. If not, simply buy the company that offers the greater potential return.

Example

If we assume that we purchase a share for $10 at "Time 1" on Figure 9.7, and then assume that over time the share price falls to $5 at "Time 2." The emotion we have with that share purchase is high, because without insurance the investment has decreased by 50%! In fact, as soon as most investors have the opportunity to sell the share again for $10 they usually would. Most investors would want to walk away from this investment without the pain of losing money. This involves patience as the share price is required to appreciate by 100% for the investor just to break even.

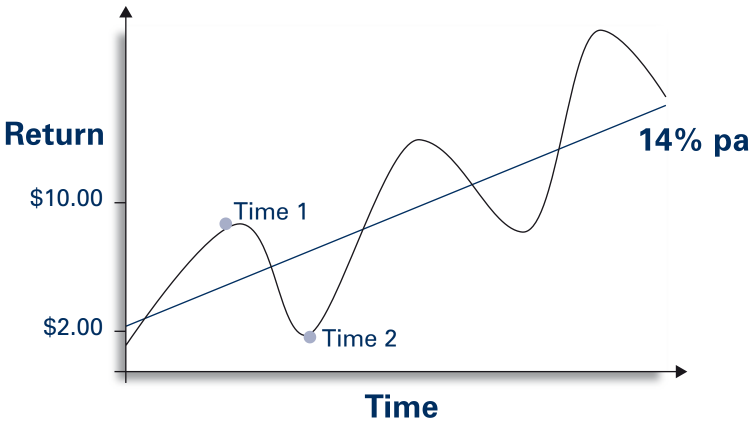


Figure 9.7 – Rolling down

To overcome the volatility associated with the share market, *The JB Way* involves insurance to protect your investment if the share price falls. This means at "Time 2" on Figure 9.7 you have the ability to sell your shares at the "Time 1" price.

Assume that at "Time 1" you purchased one share at $10, and at the same time purchased insurance consistent with *The JB Way*. At "Time 2" when the share price has fallen to $5, you have the ability to sell the share at $10. That is, you exercise your right to sell your share at $10 through the put option. This means that you would still have $10 in cash available to invest even though the share price is trading at $5.

Assuming that you believe that the underlying company was still a good *long-term* investment at $5, you would have the ability to purchase, not one, but two shares at $5. This would fully utilise your $10 in cash available. If the share price then increases, you make money. At "Time 3" on Figure 9.8, when the share price returns to $10, you make a large profit.

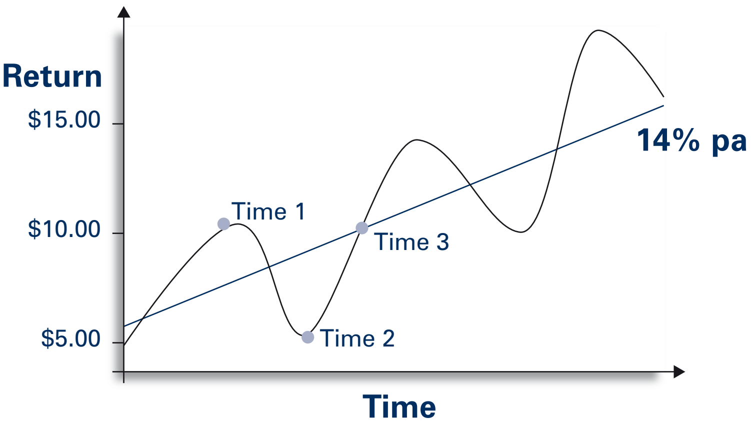


Figure 9.8 – The benefit of active management

If the share price returns to $10, instead of your capital being worth the same (the $10 initially invested), your capital is worth $10 multiplied by now two shares – $20. This is double the amount of your initial investment, when the share price is merely trading at your initial purchase price.

A simple way of thinking of the term Active Management when combined with *The JB Way* is that when the share price increases, you make money. When the share price falls, you have the opportunity to make shares.

With this in mind, if the *long-term* return of the Australian share market is approximately 14% per annum, then by adopting a *focussed* investment philosophy with capital protection, you have the ability to significantly outperform the *long-term* market return.

The above examples assume that the cost of the put option is offset by the dividend income received. Below is a real life example of Active Management.

Case Study – Rolling down

BlueScope Steel (BSL)

BlueScope (BSL) – 19th September 2005	
Purchased 4,000 shares at $10.00	$40,000
Purchased four BSL put options expiring in September 2006 with a strike price of $10.00	$3,940
Total Outlay	**$43,940**

Unfortunately over the next six months to 1 March 2006, the share price of BSL fell from $10.00 to $6.50 per share – a decrease of 35%. Rather than waiting until the expiry of the insurance in September 2006, the investor decided to implement Active Management by rolling down the investment.

BlueScope (BSL) – 1st March 2006	
Total dividend received	$2,880
Exercise the BSL $10.00 put options – September 2006 expiry	$40,000
Total proceeds available	**$42,880**
Purchased 6,000 shares at $6.50	($39,000)
Purchased six BSL put options expiring in March 2007 with a strike of $6.50	($3,880)
Funds required to implement Active Management	**($42,880)**

Even though BSL share price depreciated by 35%, the actual loss by selling the first position was limited to $1,060 or 2.4%.

$43,940 – $42,880 = $1,060 or 2.4%

If the investor still believed in the *long-term* outlook for BSL, they can reset the entry level at the new price of $6.50. In this example, the investor also extended the protected term by six months with Active Management. As a result, the investor could benefit from all the upside share price movement in BSL above $6.50 per share.

With the available funds of $42,880 from the sale of the initial position, the investor was also able to increase their holding to 6,000 shares at $6.50, thereby making 50% more shares when the price had fallen.

In March 2007, BSL was trading back at $10 per share. The value of the investors' investment in BSL was $60,000. This represents a gain of 50%, yet the share price was merely trading at the initial purchase price. Had the investor just held the initial position and if they did not implement Active Management, they would not have made any gains.

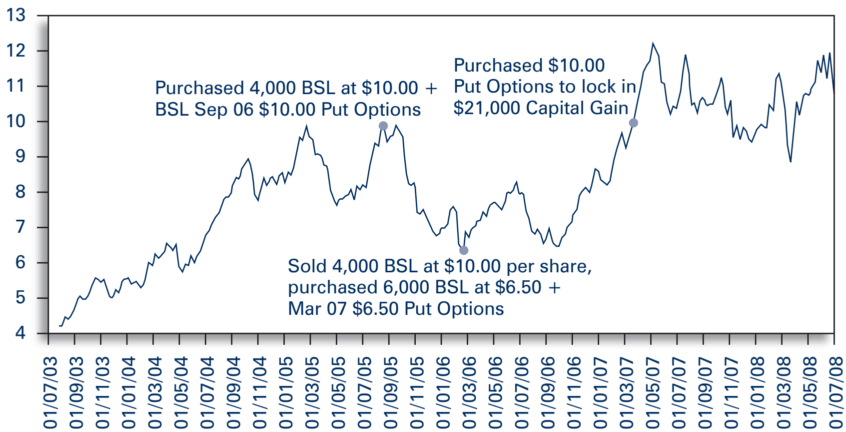


Figure 9.9 – Rolling down

Chapter Summary:-

- Active Management should not be confused with speculating or trading.
- Markets go up and go down, but generally over the *long-term* the trend is up.
- Active Management involves making money when the share price increases and potentially making shares when the price decreases.
- There are two types of Active Management:-
  - Rolling down; and
  - Locking in gains.

- Rolling down is a process that can be implemented if the underlying share price falls – the aim is to sell at the initial protected price and buy more shares at the lower price.
- Locking in gains is a process that can be implemented if the underlying share price increases – the aim is to prevent the investor from selling too early because of fear of losing gains.
- Active Management gives you the benefit of hindsight.
- Active Management only works when all of the other components of *The JB Way* have been implemented.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

"What a week!"

Chapter Ten

The Benefit of Leverage

One of the main ways that so many Australian's have accumulated wealth over the past 20 years, despite shares providing a superior return, is through property. I believe that there are two factors as to why this is the case.

The first factor is time. People generally hold property for several years, not months. People view property as a *long-term* investment. They do not have the price assessed on a minute-by-minute basis like shares. This means that there is less emotion associated with the price movements of their asset. Less emotion to think that they should be buying or that they should be selling. With property, the only time that you truly know the value of your asset is when you buy the property and when you sell it. The average holding period for a property in Australia is seven years.

The second factor why I believe that property has accumulated wealth for so many Australians is the fact that you can put down a deposit of 10-20% and control 100% of the asset value. The bank lends us the remaining 80-90% of the property cost. As the asset value increases over time, the return that we achieve on our initial deposit is magnified (provided the asset price increases at a rate greater than the interest cost). In financial terms, this is expressed as leverage.

Example – Property

In this example, let us assume that the investor purchased a property ten years ago for $100,000 and borrowed 80% of the value of the home or $80,000. This requires the investor to contribute $20,000 from their own pocket, but gives them control of the $100,000 property. Today, ten years later, let's assume that the house is worth $200,000. As the investor only contributed $20,000 from their own pocket, the return on their initial capital is 500%. That is, they have made $100,000 from an outlay of $20,000. This is a very simple example as the example ignores transaction costs and assumes that the rental income covers the interest costs which is rarely the case. However, the aim of this example is not to analyse property as an investment, but to show why so many Australians have used leverage to magnify profits.

Investors use leverage because by adding borrowed funds to your own, you can reach your financial objectives or achieve higher goals sooner than you could otherwise – the more money working for you, the greater the potential return.

Leverage is simply borrowing to invest. You can borrow funds to buy shares through what is called a margin loan.

Thankfully, when we follow *The JB Way*, we are paying someone a premium to take the majority of the risk if the share price falls. If a lender has access to this put option then they would be prepared to lend up to 100% of the protected value of those shares, as some other institution is guaranteeing the repayment of the loan, if the underlying share price falls.

To work out the impact of leverage, we must first look at our returns when we do not borrow to invest. Figure 10.1 illustrates the pay-off for an investor who buys a share without using leverage or insurance.

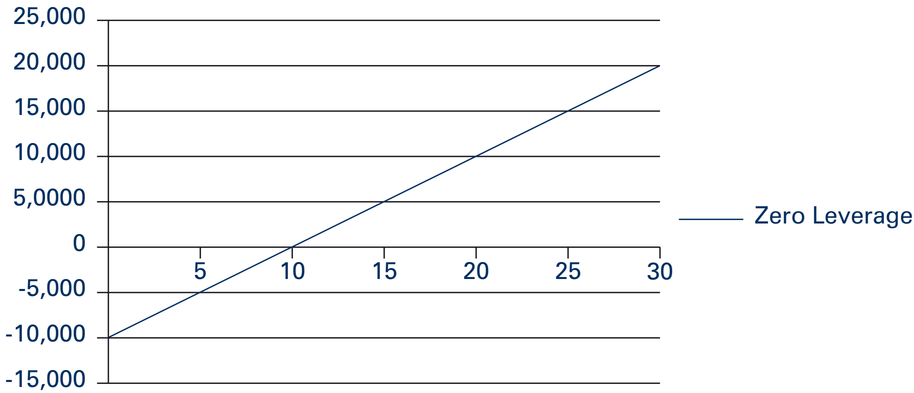


Figure 10.1 – No Leverage

The horizontal axis on Figure 10.1 illustrates the share price, whilst the vertical axis illustrates the potential return for any given share price. As can be seen in Figure 10.1, as the share price increases so does the potential return.

When combining borrowed funds with your own (at an assumed leverage ratio of 50%), the investor pay-off is as follows:-

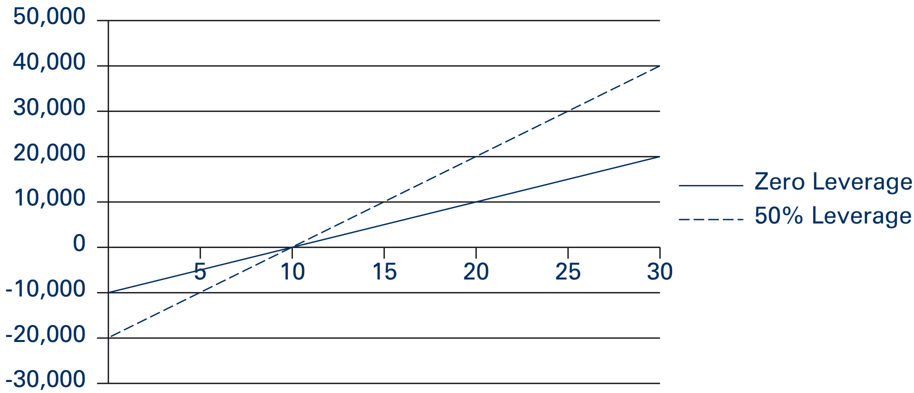


Figure 10.2 – No leverage vs 50% leverage

As can be seen from Figure 10.2, the addition of leverage has the potential to magnify positive returns as the share price increases. However, leverage also has the potential to magnify negative returns as the share price falls. In this sense, leverage can be seen as a double-edged sword.

If we are going to buy shares using leverage or borrowed funds to buy shares, surely it is more important to insure our shares against a price fall?

When you apply *The JB Way* investment philosophy with leverage, the only outlay required by the investor is the premium for the put option, and of course as the investor has now borrowed funds, they also must fund the ongoing interest expense.

Figure 10.3 illustrates the difference between *The JB Way* combined with 70% leverage versus a regular margin loan with 50% leverage, and simply holding the underlying shares without leverage or protection.

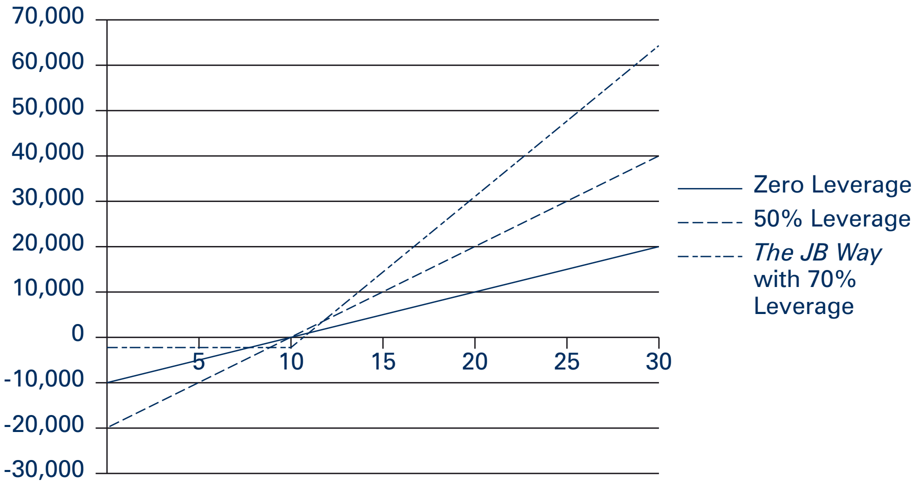


Figure 10.3 – The JB Way with 70% leverage vs no leverage vs 50% leverage with no protection

Figure 10.3 shows that for $10 upward share price movement, the return for *The JB Way* with 70% leverage is over 300% more than the return from an investment with no leverage.

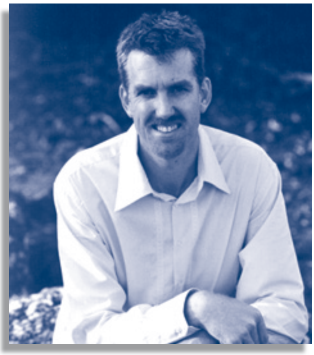
For a $10 downward share price movement, even though *The JB Way* has three times more invested in this example with 70% leverage, the loss is smaller than the loss with no leverage. So the returns can be far greater under *The JB Way* with less risk even with such high levels of gearing because of the insurance.

Therefore, we can conclude that *The JB Way*, when combined with leverage, has all the benefits of leverage, insofar as positive returns are magnified as the share price increases. However, with the addition of insurance through put options, negative returns are limited if the share price falls.

The only time no leverage can provide a higher return than *The JB Way* is if the share price stays approximately the same. That is, if the share price stays at $10, the loss for *The JB Way* with leverage will be higher than the loss with no leverage because of the cost of the put option contract plus the additional interest expense.

As you have borrowed money to increase your investment amount in the hope to maximise returns, you also have increased risk as you have the ongoing obligation to pay the interest expense. Therefore, when using leverage, the risk of *The JB Way* is the premium paid for the put option plus the interest expense. You also need to include any transaction costs to buy and sell.

Case Study – *The JB Way* with 70% leverage



David is 28 years old and has a huge appetite for risk. As such he is willing to invest with aggressive levels of leverage to hopefully accelerate the returns.

Given David's age and risk tolerance, he can take on more leverage than Peter and Ann from previous case studies.

To keep things simple, let's use Westpac again for this case study.

David chose to invest using 70% leverage in order to increase the number of shares he could buy.

Westpac (WBC) – 1st September 2005	
Purchased 1,000 shares at $19.50	($19,500)
Margin Loan	$13,650
Purchased a WBC put option for each of the shares expiring in June 2006 with a strike of $19.50	($1,150)
Initial Outlay	**($7,000)**
Plus 9 months interest expense (at 10%pa interest rate)	($1,024)
At risk capital	**($2,174)**

By combining a margin loan with insurance through put options, David was able to purchase $19,500 worth of Westpac shares with an initial outlay of only $7,000.

David's risk was limited to $2,174 for the entire holding period. This is the premium paid for the put option plus the total interest expense. This amount is before any dividend income is included.

After the dividends have been included, the net cost was only $654 meaning that the WBC share price only needed to appreciate by 3.4% for David to break even.

Prior to the expiry of the put options, WBC share price traded at $25.00. The value of David's investment had increased by $4,846. Remember, David's initial outlay was $7,000.

At $25.00 per share, by using leverage (albeit a lot of leverage) David has achieved almost a 70% return on his initial investment when the share price has only increased in value by 25%.

This is why so many Australians love to use leverage.

"I don't look to jump over 7 foot bars;
I look around for 1 foot bars I can step over"

Warren Buffett.

This level of gearing is not for the faint-hearted. The risks of borrowing at such high levels are significant.

Once David's insurance had expired, he was faced with several alternatives. He could sell the shares at $25.00 or lock in profits by buying further insurance – see previous Chapter.

In the classic story of the 'Tortoise and the Hare,' David is certainly 'the Hare,' but there is nothing wrong with being the 'Tortoise' when it comes to investing. Remember in the story, the 'Tortoise' (who took the slow and steady approach) kept his focus on his *long-term* goals, and kept plodding along and actually won the race. In fact, by using lower levels of gearing you might reach your investment goals sooner.

For those of us who require a little more certainty, and have a little more patience than David, less gearing such as this next example could be more appropriate.

Case Study – *The JB Way* with 50% Leverage

Michael and Sue are in their 40s and as such want to protect the majority of the capital they have worked so hard to accumulate. That being the case, they also understand that by using some leverage can accelerate their investment returns. They are not as aggressive as David, but are willing to invest with more risk than Peter and Ann.

Michael and Sue are firm believers in Westpac as a company, just like Peter, Ann, and David. They chose to increase their investment in Westpac by using 50% leverage combined with capital protection, following *The JB Way* investment philosophy in an attempt to hopefully achieve their investment goals.

Westpac (WBC) – 1st September 2005	
Purchased 1,000 shares at $19.50	($19,500)
50% Margin Loan	$9,750
Purchased a WBC put option for each of the shares expiring in June 2006 with a strike of $19.50	($1,150)
Initial Outlay	**($10,900)**
Less 9 months interest expense (at 10%pa interest rate)	($731)
Capital at risk	**($1,881)**

By combining a 50% margin loan with put options, Michael and Sue were able to purchase $19,500 worth of Westpac shares with an initial outlay of $10,900. The $10,900 was for 50% of the share investment plus the premium paid for the put option. The remaining 50% of the share value was funded by the margin loan.

After we add back the total dividend benefit, Westpac share price only needed to appreciate by 1.8% for Michael and Sue to break even. The upside profit potential above this point is almost double compared to the return without leverage because Michael and Sue simply have twice as much invested.

Prior to the expiry of the insurance, Westpac shares traded at $25.00.

At $25.00 per share, Michael and Sue have made a profit of $4,769 or a return on their initial capital of almost 38%. This was achieved while only risking $1,881 of their funds.

The JB Way with 50% leverage gave Michael and Sue the capacity to invest a far greater amount, meaning that they had the capacity to reach their investment goals sooner.

The more money working for you, the greater the potential return.

Comparative Analysis

All three alternatives have invested following *The JB Way*. That is, all three understand the benefit of having insurance. The level of gearing which is appropriate to you depends on your risk tolerance.

	Peter + Ann	Michael + Sue	David
Risk Profile	*Conservative*	*Balanced*	*High Growth*
Leverage	0	50%	70%
Initial Outlay	20,650	10,900	7,000
Investment Amount	19,500	19,500	19,500
WBC Share Price			
$0.00	-1,150	-1,881	-2,174
$5.00	-1,150	-1,881	-2,174
$10.00	-1,150	-1,881	-2,174
$15.00	-1,150	-1,881	-2,174
$20.00	-650	-1,382	-1,674
$25.00	4,350	3,618	2,149
$30.00	9,350	8,618	8,326
$35.00	14,350	13,618	13,326
$40.00	19,350	18,618	18,326

Table 10.4 – No Leverage vs 50% Leverage vs 70% Leverage

Table 10.4 shows that Peter and Ann's maximum downside risk is only $1,150. Michael and Sue's risk is $1,881, and David's risk is $2,174. The additional risk is directly correlated to the level of gearing.

That being the case, Peter and Ann's initial outlay was $20,650, Michael and Sue's outlay was $10,900 and David's outlay was $7,000. So whilst David had the highest risk, he has contributed the least from his own pocket. That is David has borrowed the largest amount.

Using 50% leverage, *The JB Way* has the capacity to significantly increase returns whilst only having a minor impact on the total level of risk. The risk of *The JB Way* for zero leverage is $1,150 or 5.9%. In comparison, with 50% leverage the risk is increased to $1,881 or 9.7% of the total amount invested. So not a huge impact on the overall risk (an additional $731), yet the returns or upside profit potential is almost double. At $25, after the dividend income, the return on the initial outlay was 28.4% with no leverage, but with 50% gearing, the return was 47% in this example – a significant performance with very little additional risk.

For 70% leverage the risk is over 31% in this example. The return on the outlay at $25 is almost 70%. So while the risks are significant with such high levels of gearing so too is the potential return.

When comparing alternative gearing levels it is important to consider the increased risk of additional leverage. This additional risk comes from the interest expense.

Borrowing funds is not for every investor. Although, using some form of leverage has the capacity to significantly increase the return for those investors willing to risk more of their own capital.

Figure 10.5 displays the risk return payoff of all three alternatives.

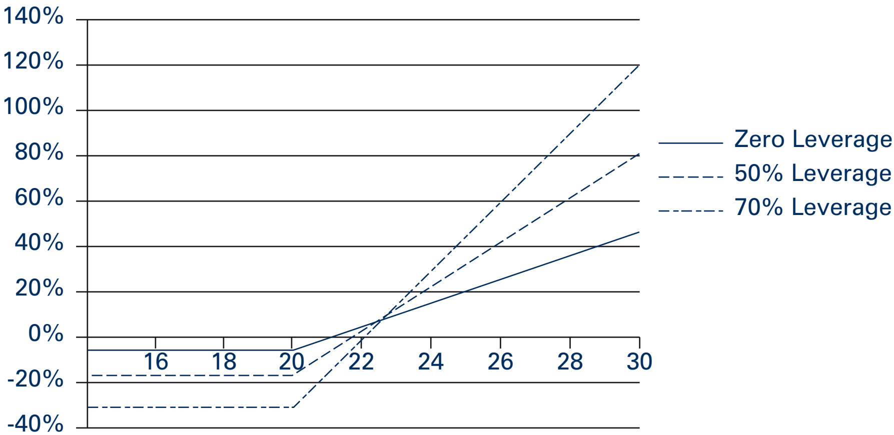


Figure 10.5 – Comparative payoff diagram

The total risk for *The JB Way*, when using leverage, is the cost of the put option plus the interest expense.

As previously mentioned, the premium for the put option can be higher or lower than what has been used in this example. The premium for the put option is influenced by the underlying company, the volatility of the share price, dividends and liquidity. The interest expense might also be higher or lower than the 10% p.a. used in this example which could also have a positive or negative impact on the ultimate result.

To determine what level of gearing is appropriate for you as an investor, you should speak to a licensed Investment Adviser.

So why would we leverage?

Simply, we use leverage to maximise our earnings potential in the same way that we borrow money to buy a house, the same way businesses borrow money to buy assets in an attempt to maximise shareholder returns. If we think that the asset is going to increase at a rate greater than the interest cost, then we would look to obtain as much of the asset as possible, using leverage. If we can achieve the historical *long-term* share market return of 14%p.a. and assume an interest rate of approximately 10%p.a., then the benefit of leverage is enormous over the *long-term*.

Figure 10.6 assumes constant 50% leverage. This means that the investment of $50,000 is taken to invest $100,000 in the market, with the balance funded using leverage. This is then reset back at 50% each year.

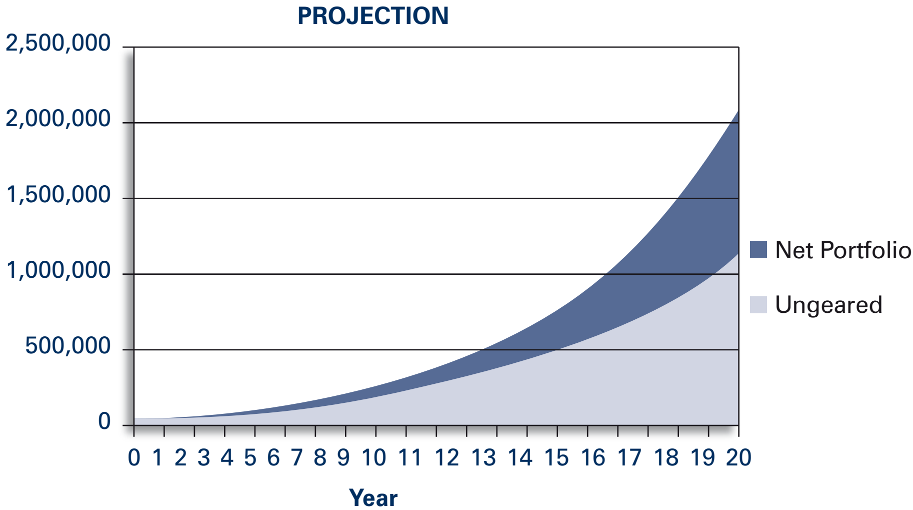


Figure 10.6 – Leverage vs no leverage over 20 years

Figure 10.6 compares a leveraged portfolio (dark blue and light blue) with the same investment without leverage (light blue section only).

After ten years, the initial $50,000 outlay has increased to approximately $380,000 when using leverage, compared to $280,000 without leverage. After 20 years, the net return with leverage is approximately $2,100,000 compared to $1,100,000 without leverage. With this level of outperformance ($1,000,000 more in profit) you would be able to achieve your investment goals much sooner. This is achieved not by choosing different assets to invest in, but by choosing to leverage. The result is also only achieved from being a disciplined investor and investing for the *long-term*.

The question an investor must ask himself is whether the *long-term* returns assumption of 14% per annum is reasonable to use as a growth rate over the next 20 years. Ultimately, we do not know the answer to that question without a crystal ball. However, by combining leverage with insurance we reduce the loss on the shares that fall in value, but we benefit in the majority of the upside profit potential when shares increase in value. We also know that the historical growth rate of 14% accounted for both the years the market increased and the years the market decreased. Therefore, if we are limiting the loss by having insurance in the years the market falls, then perhaps we have a better chance of outperforming historical returns over the *long-term*.

Chapter Summary:-

- Leverage is simply a term that describes borrowing to invest.
- Leverage can accelerate gains and also magnify losses. However, with insurance the investor receives all the benefits of leverage without the usual risks.
- With insurance, the investor can borrow up to 100% of the protected value of the shares held.
- The risk for *The JB Way* when combining leverage is the insurance premium plus interest expense, less any dividend income.
- Even with insurance, leverage does not suit every investor.
- As the level of borrowing increase so too does the level of risk. When the amount borrowed increases, the interest expense increases proportionately.
- For the right investor, leverage can be a tool that accelerates the *long-term* performance of their investment significantly.
- You should consult a licensed Investment Adviser to determine what level of leverage is suitable for your investment needs and risk profile.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.

WOULD YOU DRIVE YOUR CAR WITHOUT INSURANCE?

So why do you insure your car but don't insure your superannuation from a market crash?

The majority of Australians insure their car, some insure their house, and others even insure their life – yet only a few know you can insure your superannuation!

The reason the majority of Australians insure their car is because they know if they crash their car the financial consequences can be dire!

The financial consequences in retirement if you do not insure your superannuation could be catastrophic!

In 2008 alone over $300 billion was lost within superannuation due to the global share market and property crash. The average superannuation fund declined by almost 30% meaning many Australians will be forced to work longer or reduce their lifestyle in retirement.

At JB Global we specialise in investment strategies that protect the majority of your superannuation if the market falls, yet the investments still give you access to enjoy high profit potential when the market rises.

To speak to a JB Global Investment Adviser to discuss how we can help you minimise risk whilst maximising returns within Super call us on 1300 522 644.

www.jbglobal.com.au

JB Global
Investment Services

Chapter Eleven

Superannuation

Back in Chapter One, the traits required to be a successful investor were discussed. They are:-

- Save, save now and save often;
- The compound effect;
- Capital Preservation; and
- Discipline.

About 20 years ago, the Australian Government realised that the way to create wealth is that it requires firstly savings, secondly the benefit of compounding and finally investor discipline.

The problem the Australian Government had 20 years ago was that over 90% of the population aged above 65 relied on the age pension. The cost of funding these people until they died was huge. With the baby boomers approaching retirement and people living longer, the cost to the Government would be astronomical to keep the age pension intact. Therefore the government was forced to introduce a forced savings mechanism called Superannuation.

Superannuation

Although many might disagree, one of the key benefits of superannuation is the investment timeframe. For most people it is many years until they will be able to access their superannuation. This means that these investors are forced to take a *long-term* view and be a disciplined investor. That is, you are forced to enjoy the wonderful thing called compounding.

Another benefit of superannuation is that it is a compulsory savings mechanism. As discussed in Chapter One, the secret to creating wealth involves you to save, save now, and save often. This involves sacrificing consumption today to hopefully increase the quality of your life in retirement.

Unfortunately, many investors view superannuation as a necessary evil. It is something that they are forced to have. It is something that the Government has imposed on them – 9% of their salary is paid as superannuation.

I often ask clients if they had the opportunity to spend their superannuation today, would they? The majority answer, "Yes"! This is because we like to have the cash in our hands today and worry about the future tomorrow. The clients who answer "no" to my question are generally clients who are closer to retirement. They value the *long-term* forced savings that superannuation has provided them because they can see the money there and they can access the money in the foreseeable future.

Irrespective of their age, all investors must understand the importance of superannuation. Superannuation is what is going to dictate whether you live the life you deserve in retirement. Unfortunately, if you do not take superannuation seriously then you will learn the hard way, which you'll only realise when it is far too late.

At the moment, we are now faced with two alternatives to fund our retirement lifestyle:-

1. Accumulate assets in superannuation; or
2. The aged pension.

Is the age pension really an option? I believe not. I believe that superannuation is clearly intended to replace the age pension in the future. I believe that anyone under the age of 45 should not be depending on the age pension to fund their retirement. The age pension will either not exist at all, or the age upon which you will be entitled to the pension will increase. That is, you will be forced to work for longer.

After all, the maximum age pension payment is approximately $14,000 per year. I know that personally I spend much more than this each year. I also know that when I retire I would like to travel more, spend more time with my family, even playing golf and enjoying my latter years. I would also like the opportunity to give my grandchildren the education they deserve and are probably going to need. No doubt this will result in spending more each year.

I have no choice but to look for superannuation to fund my retirement. I have no choice but to value the contributions made to my superannuation. I have no choice but to make sure that I achieve the best possible return for my superannuation each and every year.

I certainly do not want to reduce my lifestyle in retirement, but unfortunately many Australians have no choice as they have failed to save enough capital.

If living the lifestyle you deserve in retirement is not enough incentive alone (i.e. having the flexibility to do what you want and when you want to do it), the Government provides us further benefits to focus on superannuation. The Government has made superannuation the most generous taxation environment upon which to make an investment, the closer we grow to retirement, we should want more and more of our wealth in superannuation.

It has been well reported in the media that there are tax benefits from investing in superannuation. But what are they?

Firstly, the tax rate for earnings in superannuation is 15% (10% for capital gains whereby the asset has been held for greater than 12 months). In most cases, this rate of tax is less than our personal rate of tax.

Secondly, upon reaching the age of 60 and permanently retiring, the tax rate in superannuation effectively drops to 0%. This means that you can wait to sell your accumulated capital assets until the age of 60 and sell those assets tax free!

Thirdly, through salary-sacrificing into superannuation we receive a tax concession that reduces our personal income tax paid today. This involves taking a portion of our salary payments before tax and investing those funds into superannuation where the tax rate is lower. Therefore we can save tax today, knowing that in the future we do not have to pay tax on the capital gains made from those contributions.

If we are putting the majority or even some of our wealth into superannuation, then we ought to make sure that we invest our superannuation in the same way that we invest our other funds. You should monitor and control the investment decision of your superannuation as much as you would your money outside of superannuation. After all, superannuation is your money! Superannuation will become your biggest asset!

The traditional portfolio approach to Superannuation

The majority of Australian's superannuation is invested using a traditional portfolio approach to superannuation. This involves selecting either a conservative, balanced, growth, or high growth portfolio. The investor usually makes this decision based on their tolerance for risk and appetite for returns. This process involves the investor handing control of the investment decision to a third party, a Fund Manager or Financial Planner.

The risk/return trade-off for each portfolio is dictated by the asset weighting. Based on historical results, the range of returns within each traditional portfolio is described in Table 11.1.

Traditional Portfolio	Approximate maximum downside risk for any given year	Approximate maximum return for any given year
Conservative Portfolio	-8%	8%
Balanced Portfolio	-12%	12%
Growth Portfolio	-20%	20%
High Growth Portfolio	-24%	24%

Table 11.1 – Risk/return of traditional superannuation portfolios

As calculated in Table 11.1, the risk/return balance is correlated with each portfolio – the greater the risk, the higher the potential return. Another observation that can be made is that the downside risk is the same as the potential return for each portfolio. This balance is generally accepted because, based on historical performance, the number of positive return years has exceeded the number of negative years. Hence, over the *long-term*, the value of each asset class has increased.

The main difference between these four models is the downside risk of each portfolio and the potential return. Which portfolio is chosen within superannuation by the investor usually depends on the investors' age. The older the investor, the closer to retirement age you are, therefore the traditional approach to superannuation implies you should take less risk and adapt your investments accordingly. They do this because they cannot afford to lose money when they are going to require their superannuation proceeds so soon to fund their living expenses in retirement. The problem with this is that whilst risk has somewhat been reduced, so too has the potential to make high returns.

The JB Way to superannuation challenges the traditional approach to investing superannuation assets. Using *The JB Way* to superannuation, you can pursue high potential gains (high growth upside) with minimum downside risk (conservative risk profile).

To relate this back to the portfolios above, you would want the high growth portfolio upside with the conservative portfolio downside. That is, the potential for returns above 24%, but with a maximum risk of 8%. If you said this to your Financial Planner, what would they invest you in? Perhaps the Financial Planner will convince you that the balanced portfolio is the best option for you, but this is not the correct answer. This is not the "Holy Grail" to investing or the perfect investment solution.

The JB Way is to have maximum potential return with minimum risk. You should not deviate from *The JB Way* just because it is superannuation.

The JB Way to Superannuation

The JB Way to superannuation involves adopting the investment philosophy explained earlier, whereby we have a *focussed* investment approach combined with capital protection using insurance via a put option. This approach is tailored for self-managed superannuation funds so that you have 100% control over the investment decisions. After all, superannuation is your money and will ultimately become your biggest asset.

By having a self-managed superannuation fund, you can choose specifically what you want to invest in. You have 100% control over the investment decisions. You have 100% control over your money. You have 100% control over what will be your biggest asset.

The JB Way to Superannuation

1. Adopt a focussed investment philosophy to ensure returns are maximised;
2. Put the bulk of your money on those shares;
3. Buy insurance; and
4. Use the dividend to offset some of the insurance premium.

Let's revisit the case study with Peter and Ann, but let's assume this time the investment was made through their superannuation.

Case Study – *The JB Way* to Superannuation

As Peter and Ann are in their late 50's and are approaching retirement, they would be considered conservative investors. Within superannuation, they want to protect the majority of their retirement capital and therefore are not prepared to take on large risks. However, as they are approaching retirement age – when they are likely to need their superannuation capital to fund their retirement – they also need to achieve moderate returns to maintain their lifestyle in retirement. Under the traditional approach to superannuation or according to modern investment theory, Peter and Ann cannot achieve both, as potential returns are implied to be correlated to risk.

However, under *The JB Way* to superannuation, Peter and Ann can achieve both. By having insurance, they can confidently invest in not just the share market, but follow a focussed investment philosophy similar to Warren Buffett to hopefully provide high returns. The only way they can do so with comfort is with insurance.

In this example, we are only investing in one company, but you should invest in at least three and no more than five different companies. This was covered in Chapter Eight.

Westpac (WBC) – 1st September 2005	
Purchased 10,000 shares at $19.50	$195,000
Purchased ten WBC put options expiring in June 2006 with a strike price of $19.50	$11,500
Total Outlay	**$206,500**

By combining a share investment in WBC with insurance via put options within their superannuation, Peter and Ann were able to reduce the downside risk on their $206,500 superannuation proceeds to only $11,500. Therefore, the risk Peter and Ann were exposed to was approximately 6% of their entire superannuation fund.

This is less risk than the traditional conservative portfolio.

This risk also assumes Westpac did not pay a dividend.

As Westpac paid its dividend, even if the WBC share price did fall below $19.50 per share, Peter and Ann would make a profit of $3,700. This is due to the fact that the total dividend income was higher than the premium paid for the put option contract. Furthermore, Peter and Ann receive all of the upside capital growth potential within their superannuation as Westpac share price increases in value above $19.50.

The returns that Peter and Ann can achieve are shown in Figure 11.2.

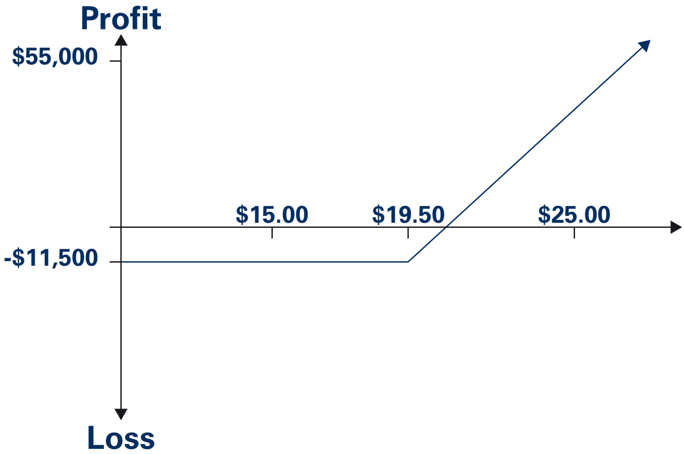


Figure 11.2 – Westpac payoff diagram when applying The JB Way to Superannuation

Prior to the expiry of the put option contract, the WBC share price traded at $25.00.

At $25.00 per share, Peter and Ann have made a capital gain within their superannuation of $55,000.

When you add back the dividend income and include the put option expense, Peter and Ann enjoyed a $58,700 gain or a return of approximately 25% within their superannuation.

That is, Peter and Ann have achieved a return of over 25% consistent with the returns provided under the high growth traditional portfolio, yet with the risk profile of the conservative portfolio. The maximum risk exposure was just under 6%.

Peter and Ann have achieved the perfect investment when it comes to superannuation, achieving the "Holy Grail" of superannuation. They have all the high capital growth potential from investing in the share market and likewise, they have enhanced profit potential from adopting a focussed investment philosophy similar to Warren Buffett, yet are exposed to minimum downside risk if the share price falls as they have insurance. This is the perfect investment.

FREE superannuation review worth $495

JB Global
Investment Services

JB Global are offering readers a FREE Superannuation Review valued at $495.

To take advantage of this offer call JB Global on 1300 522 644 and mention this ad or complete this form and email it to superannuation@jbglobal.com.au or fax to our offices in Sydney (02) 8114 2200, Melbourne (03) 9686 4589 or Brisbane (07) 3012 8695.

☐ **Yes I'd like to receive a FREE Superannuation Review**

Details

First Name: ______________________

Surname: ______________________

Address: ______________________

____

Contact Number: (w) (   ) ______________ (m) ______________

Email: ______________________

Spouse Details

First Name: ______________________

Surname: ______________________

Address: ______________________

____

Contact Number: (w) (   ) ______________ (m) ______________

Email: ______________________

Date of Birth (DD/MM/YY): ____ / ____ / ____

Name of Superfund(s) (If known):

1. ______________ Membership No: (If known) ______________

2. ______________ Membership No: (If known) ______________

3. ______________ Membership No: (If known) ______________

For more information, visit our website at www.jbglobal.com.au

By following *The JB Way* investment philosophy, Peter and Ann have achieved their superannuation goals to have high profit potential so that they can potentially enhance their retirement lifestyle and live the life they deserve. All this while being exposed to only limited risk due to the insurance.

As you have all the upside profit potential with very little risk, why wouldn't you implement *The JB Way* to superannuation investment philosophy?

Stop paying fees for poor performance and start being accountable for your superannuation proceeds. Start taking control of what will be your biggest asset!

Superannuation can be SUPER, but only when you invest following *The JB Way*.

Chapter Summary:-

- Superannuation is compulsory savings enforced by the Government and as such, will become the largest asset for most Australians.
- As superannuation will fund your retirement, ensuring your proceeds are capital protected is a must. Returns also should be maximised to increase your standard of living in retirement. Achieving higher returns could also mean the possibility of retiring early.
- Significant tax benefits exists for superannuation
- The normal 'traditional' investment approach is outdated and fails to ensure maximum returns are achieved with minimal risk.
- *The JB Way* to superannuation has the capacity to change the way you think about your superannuation funds. Irrespective of your age, risk profile or investment goals, *The JB Way* to superannuation can protect the capital you have already worked so hard to accumulate, whilst ensuring your returns are maximised by adopting a focussed investment philosophy.
- Investment decisions should be based on an individuals own goals, time horizon, and tolerance for risk. You should seek professional investment advice prior to investing.


GOD HAS CHOSEN ME TO TALK TO YOU ABOUT SUPERANNUATION
GROSZ

Chapter Twelve

The JB Way

I am sure you agree the risk of *The JB Way* is very, very low risk in comparison to just buying shares following the traditional buy and hold approach.

As *The JB Way* involves significantly less risk than the usual traditional buy and hold approach, then usually the returns should also be less. However, by following a focussed investment philosophy similar to Warren Buffett, and by having the ability to sell the poor performing shares at the protected price gives *The JB Way* the potential to still provide high returns. In fact the returns from *The JB Way* have historically been higher than the general market.

As *The JB Way* involves significantly less risk than the general market because you have insurance, and has previously consistently provided a higher return, have we proved *The JB Way* is the "Holy Grail" when it comes to investing? Is *The JB Way* the perfect investment? Is *The JB Way* the investment strategy you have been searching for? Is *The JB Way* an investment strategy that gives you the certainty to make an investment decision without fear? Is *The JB Way* an investment strategy that you can implement and still sleep at night knowing the majority of your investment capital is protected? Is *The JB Way* the investment strategy that can accelerate your returns to ensure that you can reach your investment goals sooner?

The JB Way gives you the capacity to maximise returns by adopting the proven focussed investment philosophy similar to Warren Buffett, yet has minimal risk due to the insurance. These features make *The JB Way* the perfect investment.

What makes *The JB Way* investment philosophy a perfect investment is:-

MAXIMISES RETURNS

To ensure performance is maximised, *The JB Way* adopts a focussed investment philosophy similar to the proven strategy implemented by Warren Buffett. This gives you the potential to achieve high returns.

MINIMISES RISK

Through the purchase of a put option, the majority of your investment capital can be protected from a decrease in value. This protection can significantly limit your losses if your portfolio falls, whilst you still enjoy 100% of the upside profit potential when the market rises.

CUSTOMISED TO YOUR INDIVIDUAL NEEDS

You can customise *The JB Way* to your own individual financial circumstances, financial needs and investment goals. You maintain control, ownership and transparency.

LEVERAGE

Up to 100% leverage of the protected value of your investment can be obtained. When borrowing money to invest, there is the additional risk of funding the ongoing interest expense. However, for the right investor, leverage can accelerate *long-term* gains. Gearing levels can also be adjusted to suit your individual circumstances and can be modified over time.

LIQUID & FLEXIBLE

Investment can be easily increased or decreased. You can protect or release your equity for diversification benefits. You can sell shares at almost any time and be paid three business days later. Shares are the most liquid asset class, behind cash.

BENEFIT OF HINDSIGHT

With Active Management, you can lock in gains as the share price increases so when the share price eventually falls you will be selling very close to the high, even though the share price is less. This is achieved by locking in gains.

As the share price falls you can roll down your position, giving you the capacity to make more shares.

If the share price increases you make money, if the share price falls you have the capacity to make shares.

CONTROL

You control whether you invest in a company or not, you control whether you keep those shares, or sell them. The decisions are ultimately yours as the investor – you are not passing on the investment decisions to a

Financial Planner, Stockbroker or Fund Manager. You are in control of your financial destiny!

THE JB WAY IS SIMPLE, SAFE AND SUCCESSFUL.

To recap, the four steps of *The JB Way*, whether you're investing in your own name or superannuation is:-

1. Adopt a *focussed* investment philosophy in the pursuit to maximise returns similar to Warren Buffett;
2. Put the bulk of your money in those shares;
3. Buy insurance to reduce risk;
4. Use the dividend income to offset some of the premium paid for the insurance.

The only variable of *The JB Way* investment philosophy equation is *YOU*. You must be a boring, disciplined investor. You must:-

- Save, save now, and save often;
- Invest, invest now and invest often;
- Always invest for the *long-term*;
- Have a plan and stick to it;
- Invest where you have the capacity to achieve the greatest possible returns. Over the past 20 years this has been the share market; and
- Always have protection.

If you follow these steps, you will make money. You do not need to earn a large wage to be wealthy, you just need to follow the aforementioned steps and ensure you take a *long-term* view. *The JB Way* has the capacity to significantly change your life.

Benjamin Graham, the author of *The Intelligent Investor* – Warren Buffett's university teacher, and the man who I believe is one of the world's all-time greatest practical thinkers – described that an outstanding investment philosophy is one that will not teach you how to beat the market in the *short-term* (no truthful book or adviser can), instead the philosophy must teach you three powerful lessons:-

1. How to minimise the odds of suffering irreversible loses;
2. How to maximise the chances of achieving sustainable gains; and

3. How to control the self-defeating behaviour that keeps most investors from reaching their full potential.

The JB Way achieves all three of Graham's lessons, and likewise precisely describes the proper framework to achieve investment success.

Warren Buffett suggests that "...to invest successfully over a lifetime does not require a stratospheric IQ, unusual business insight or insider information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework."

If you follow the investment principles outlined within this book, you will not get a poor result from your investments. Whether you achieve outstanding results or not, will only depend on your emotional aptitude, willingness to be a disciplined *long-term* investor, and your ability to actually take action and invest in the first place.

Surround yourself with a team of experts

"If you want to be rich, who you know is often more important than what you know"

Robert Kiyosaki

Something that I live by is that I don't need to know the answer to all questions in life. What I do need to know is where to find out the answers.

Everyone in life is a specialist at something and everyone in life has a passion. Whether your passion is your job – be it a doctor, mechanic or teacher – or your passion is to be a good parent, then you are a specialist at what you do. You are the person to speak to when I need the answer to a question in your field of expertise.

My approach to business and investing is the same. I do not want to live my life being a "jack of all trades and a specialist of none." I want to be a specialist. As a specialist, I can pursue my true passion in life. For me, my core competence and field of expertise is the share market.

In investment markets, and business for that matter, you need a few specialists. You need a specialist Investment Adviser to conduct research and monitor your investments. You need a Stockbroker to implement your investments. You need a specialist Accountant to manage your tax. Collectively, these people can become your team of experts to guide you to financial success.

The late Kerry Packer was a big advocate of surrounding himself with a good team.

When a problem arose in business, Kerry would aggregate his team of Accountants, Investment Advisers, Lawyers and Managers all together in a room to sort out the problem. Meanwhile, he would be out pursuing his other passions, be it another business deal or a game of polo.

Don't be afraid to pay experts for their services. The cost of their expertise will generally be much less than the cost of fixing mistakes that you make as you attempt to go it alone.

"Business and investing are team sports. The average investor or small business person loses financially because they do not have a team. Instead of a team, they act as individuals, who are trampled by very smart teams."

Robert Kiyosaki

Remember that you are not alone in starting the journey to share investing. I have guided thousands of new investors from all over the world to take the first step through seminars and educational workshops. Whilst this has mainly been achieved through my company, JB Global Investment Services, where we have helped those investors take action and implement the investment philosophies discussed within this book. Now you have read this book, please visit our website *www.jbglobal.com.au* for further education on investing and creating unlimited wealth.

"It's better to hang out with people better than you. Pick out associates whose behaviour is better than yours and you'll drift in that direction"

Warren Buffett

Use your time in life wisely, as it is one thing that you cannot buy more of. Use your time to pursue your true passions in life.

Next Step

The first step to achieving your financial dreams begins with increasing your knowledge about investing. I applaud you for taking that first step to increase your knowledge by reading this book, although education is only the first step of many. I do not agree with the statement that 'Knowledge is Power.' Knowledge only becomes powerful when that knowledge is applied.

You will only achieve your financial goals if you actually take action and invest.

Take action by developing an investment plan, ensure within this plan you have long-term goals, and like the tortoise, start plodding to the life you deserve.

"When you think about something it is a dream, when you envision it, it's exciting. When you plan it, it's possible. But when you do it, it's real."

Anthony Robbins

This book encompasses my findings from over ten years of my life being devoted to studying investment psychology, combined with the results of 15 years of personal investment experience. Investing is one of my main passions in life and thankfully one of my talents.

You are now obligated to take action and invest. Again, knowledge only becomes power when that knowledge is applied. I have failed in my goal of writing this book if you do not go forth and take action and invest.

"The future depends on what we do in the present."

Mahatma Gandhi

There is nothing to be fearful of when it comes to investing within the share market provided you invest with insurance. Let someone else worry about the possibility of the market crashing!

The best time to take action and invest is NOW! Irrespective of your age, gender or the amount of money you have. The power of compounding means that *TIME* in the market is a wonderful thing.

So what are you waiting for?

Now you have read this book, I encourage you to share your new found knowledge. Do not merely place this book back on the shelf to collect dust. Share this information with family members, friends and neighbours. If you know someone that could benefit from the information contained within these pages, whether they seek high capital growth, or to protect their retirement funds, or simply just want to improve their lifestyle, you owe it to your friends and family to share the information contained within this books pages. They might have already accumulated wealth within superannuation, sold a house, already have a share portfolio, or just finished school and joining the work force for the first time. Everyone, whether rich or poor, young or old, who aims to maximise returns and minimise risk – *this book is for them.*

If your family or friends want certainty when it comes to investing (like Peter and Ann) or if they have an appetite for risk (like David), *The JB Way* can help them achieve their financial goals.

As the Author, I do not mind if you give this book to a family member or friend. In fact, this is my aim and I encourage it. I am not in the business to profit from selling books, so I don't need to make any royalties. My aim is to educate as many people as possible about the benefits of *The JB Way*, and then to help those people actually take action and implement the investment philosophy. My aim is to help as many people as possible become financially free. So give this book to as many people as possible.

If you were given this book, you are now obligated to do three things:-

1. Thank the great friend that gave you this gift;
2. Pass the book onto someone else;
3. Actually take action and invest. You will not regret investing, just ensure you take a *long-term* approach, and protect your assets which you have already worked so hard to accumulate.

To me, the meaning of life involves devoting yourself to *long-term* progression, and to devote yourself to creating something that gives you purpose and meaning. This book is what gives me purpose and meaning and is my gift to you. Use my time, my talents, and my treasures wisely.

"SUCCESS IS AT ARMS REACH, SO WHY ARE YOUR ARMS FOLDED? BE NOT YOUR OWN ENEMY BY PROCRASTINATION; INSTEAD BE YOUR OWN HERO BY SELF-MOTIVATION. JUST DO IT!"

HAPPY INVESTING!

Advanced Risk Management Techniques

If you believe internationally listed companies like Warren Buffett's Berkshire Hathaway, or sectors such as Renewable Energy, or countries such as India or China offer great upside potential you can still enjoy all the upside potential from these investment opportunities, with capital protection.

To do this we can use 'Structured Investments'.

A structured investment is similar to a managed fund where your investment funds are pooled with many other investors. By pooling your funds the costs are less as you gain greater economies of scale.

Structured Investments, if Europe, Hong Kong, and New York are any indication, will become the most popular investment vehicle over the next 10 years in Australia. Australian investors are rapidly beginning to see that these investments give all the upside profit potential of high growth assets without the usual high risks associated as they encompass capital protection. The cost of the 'insurance' is usually very cheap, and the bank will lend at a high level (sometimes up to 100% of the investment) as the investment has capital protection.

The structured investment market has been available to retail investors in Europe for more than 20 years, and it is massive. In 2008, new retail structured investment offerings in Europe raised over AUD270 *billion* for the year.[1] Currently, structured investments are the fastest growing financial product.

The future growth prospects in Australia for structured investments are huge. As structured products are relatively new to Australia, the growth here is tipped to be enormous over the next 10 years.

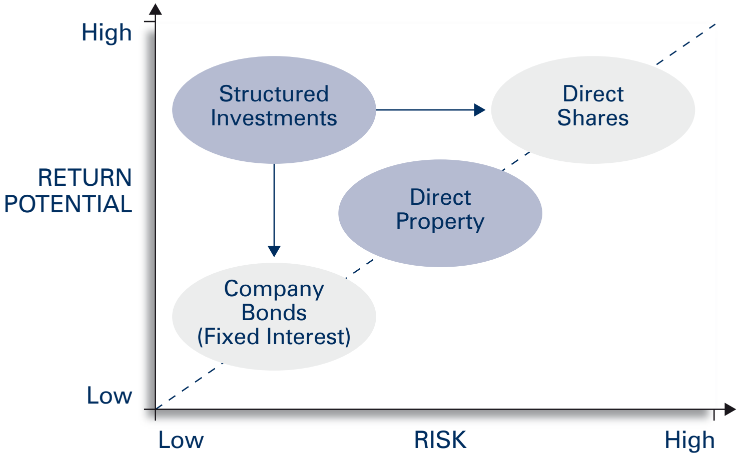
1 Euromoney: Structured Products: Double your guess for retail market size. Sept 2008

If you desire high levels of leverage, high growth potential, plus cheap forms of protection, structured investments can meet all your needs.

Risk Profile of Structured Investments:

As the underlying capital protection is provided by an individual company (eg a bank) the risk profile of a structured investment is the same as a company bond or fixed interest security. However as the return is usually derived from growth assets, such as shares, the return potential is significant.

Once again with capital protection, we have proved modern investment theory is outdated and to achieve high returns you do not need to be exposed to high risks.



As you can see, structured investments have the same low risk profile as a company bond. This is because the underlying risk of a structured investment lies with the counter party of the company bond, generally being an A+ credit rated bank.

Why use structured investments;

- If there is limited access to the specific market you would like to invest in structured investments may give you the ability to invest with the benefit of capital protection
- The tenor can be set at between 3-7 years

- The cost of protection is relatively cheap
- With structured investments the bank will usually lend money to invest on a limited recourse basis as the investment is protected in most instances, your monetary risk is quantifiable at the beginning of the investment (ie you can know exactly on day one how much you could possibly loose)
- The usual additional risks of investing in international markets, such as foreign currency risks, can be eliminated
- The underlying asset can be a single company, a basket of companies, likewise an index
- Structured Investments can give you access to high growth, high income potential investments without the usual risks

Risks of Structured Investments

- The main risk is counter party risk. That is the risk of the company providing the capital protection going broke. This risk can be managed by selecting banks with a high credit rating only, or by borrowing on a limited recourse basis
- For structured investments you are usually offered quarterly liquidity, meaning you can sell your investment every three months
- The capital protection is usually only valid at maturity so if you decide to redeem prior to maturity you may experience a loss
- As Structured Investments are usually tailored, additional risks exist but depend on the exact structure of the investment. Investors should consider the product disclosure statement of each investment to gain a full understanding of the risks specific to each investment

Example 1 ñ JB Global's Berkshire Hathaway, Income and Equity Accelerator
In March 2010, JB Global released the fourth of its *Income and Equity Accelerator Series (IEA4)*. IEA4 is a structured investment based on arguably the greatest investment company of all time ñ Berkshire Hathaway, chaired by Warren Buffett and listed on the NYSE.

Some of the key features of the IEA4 include:

- Exposure to the greatest investor of all time, Warren Buffett
- 100% lending at 4.95% interest rate per annum
- 3 year term
- Two potential contingent coupons up to 8.1% PLUS unlimited capital growth potential
- No currency risks for Australian investors for 0.5% p.a.
- 6 risk management techniques built into the investment structure as outlined below.

This investment was the first of its kind that I know of, that was able to adopt six advanced risk management techniques, whilst having exposure to the world's greatest investor.

Risk Reduction Mechanisms

1. Capital Protection

The benefits of capital protection have been described above in some detail. This form of insurance also protects an investor against receiving any margin calls.

2. Limited Recourse loan

A Limited Recourse Loan limits the borrower's liability to the interest they have paid upfront. In this case for this specific investment, the liability is limited to the 3 years of interest at 4.95% p.a. plus the foreign currency hedging fee of 0.5%. So, there are no further repayments required or liabilities. The maximum risk is capped at the expenses paid upfront. There is no additional recourse back to you as the individual. You can simply walk away.

3. Dollar Cost Averaging 'Averaging in'

Dollar Cost Averaging is simply buying shares in the same company at different times. The aim is to average out your purchase price.

Whether the share market is rising or falling, you can do well if you pick its highs and lows. The trouble is, of course, that it's not a simple thing to pick those peaks and troughs. Correctly timing your entry into and out of the markets is the Holy Grail of investment and virtually impossible to do repeatedly without an operative crystal ball.

An Example of traditional Dollar Cost Averaging

John wants to buy $30,000 worth of ABC shares, but is concerned about investing all his funds into the market at once, especially considering current market volatility.

John decides to adopt a dollar cost averaging risk reduction mechanism. He decides that at the same time every month, for three months, he will buy $10,000 worth of ABC shares. The table below shows these purchases being made.

Date	Price/Share	Shares	Cost
Jan. 1st	$20	500	$10,000
Feb. 1st	$15	667	$10,000
Mar. 1st	$18	555	$10,000
	Total	1,722	$30,000
		Avg. Price Per Share	$17.42

As you can see from the table above, Johns average share purchase price was $17.42. Because the stock is now worth $18, his portfolio is worth $31,000. If John did not use DCA, his purchase price would have been $20, and his portfolio would only be worth $27,000.

For the JB Global IEA4, Berkshire Hathaway structured investment, we entered the market over the first three months and in doing so minimised risk and improved the potential returns.

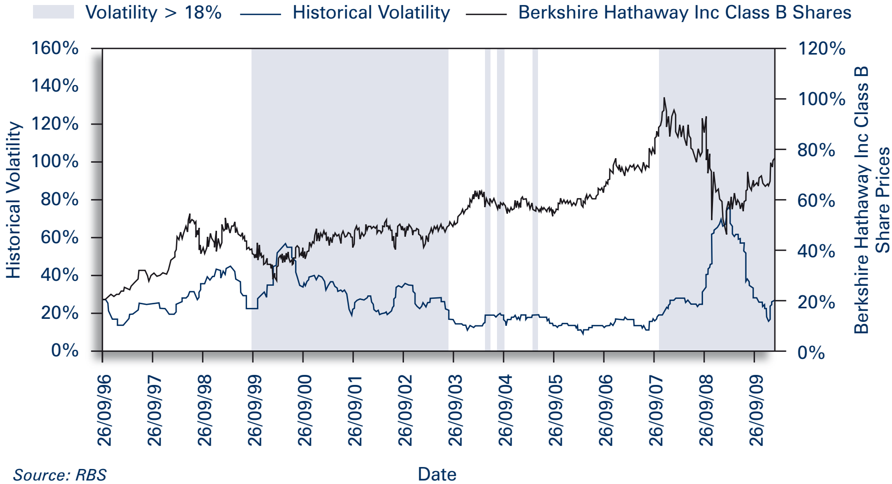
4. Dollar cost averaging 'averaging out'

Just as the entry is 'averaged in' over the first 3 months to reduce the entry timing risk, we 'average out' to reduce the exist timing risk. I.e. we sell 1/3rd of the investment each month, for the last 3 months of the investment.

5. Volatility Management

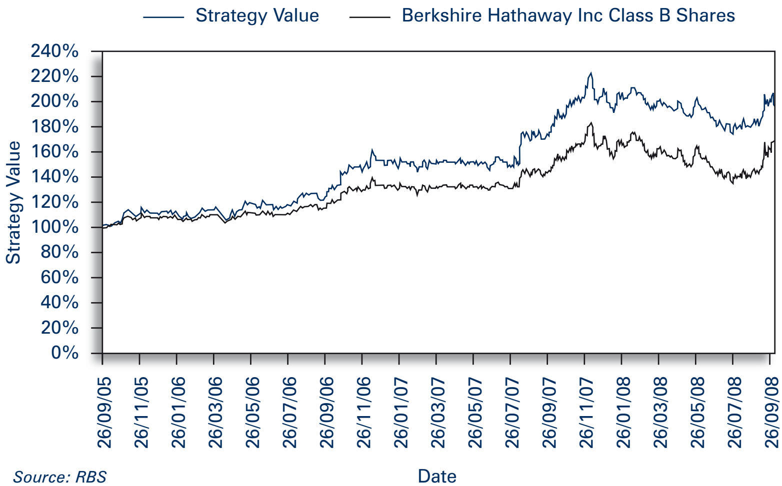
Typically the share market is falling when volatility is high. Conversely, when volatility is low, the share market is typically rising. From this observation it makes sense to have less exposure to the market when volatility is high, and greater exposure to the market when volatility is low.

The chart below compares historical volatility with the performance of Berkshire Hathaway since September 1996 to January 2010. In mid 2007 volatility started to increase which was followed by one of the worst market falls in history. From 2000 to 2007 volatility was low which coincided with a long term upward trend. This highlights how volatility and the performance of the share market are often inversely correlated.



Source: RBS

How a volatility targeted investment would have performed during these periods is described in the chart below. As can be seen, volatility targeted investments have the capacity to significantly outperform the share market, or in this case, Berkshire Hathaway. The average 3 year return from Berkshire Hathaway over this 15 year period was 24.28% versus 32.27% from the volatility targeted investment.



Source: RBS

When you consider the technical rationale for volatility targeting and see how it can deliver real benefits in practice, it is clear that this new technology has a bright future.

Volatility targeting is a complicated risk management tool and requires a structured investment to implement. You can not invest following this technique yourself without devoting an enormous amount of time to follow the markets each and every day. This is ok, as that's why companies such as JB Global offer such investment opportunities. We manage this investment process for you. Due to the pooling of funds you also gain economies of scale so the costs of implementing such a technique is spread over hundreds of investors making such a risk management tool inexpensive for all individual investors.

6. Currency Hedging

Currency hedging allows us to eliminate the risks associated with foreign exchange rate movements. As Berkshire Hathaway is listed on the NYSE, its share price is denominated in USD. Therefore AUD/USD currency risk exists. Within a structured investment, we are able to obtain wholesale hedging rates to eliminate this risk, usually at a cost of only 0.55%pa of the investment amount.

Case Study 1: $200,000 Invested in the JB Global Income and Equity Accelerator Berkshire Hathaway Series with 100% leverage

Sharon is an avid Warren Buffett fan and has always wanted to invest in Berkshire Hathaway but has never invested due to fears about investing off shore due to foreign currency risk. Sharon also has no idea as to what is involved in setting up a US stock broking account or how to actual buy the shares themselves. One share also costs over $100,000 at the time of writing this book so to buy just one share in Buffett's company Sharron will need to come up with a lot of money.

A structured investment gives Sharon the capacity to ride on Buffett's coat tails and enjoy in any increase in Berkshire Hathaway's share price without the usual problems described above. Sharon invests just $37,400 from her own back pocket to cover all the interest expense for the entire three year investment period. She has nothing else to pay, yet Sharon has a total of $200,000 invested. Sharon can enjoy in up to 8.1% pa in income and any capital growth the investment offers over a 3 year period within her SMSF.

Invested Amount:	$200,000
Interest Cost for 3 years:	$29,700
Currency Hedging Fee:	$3,300
Establishment fee:	$4,400
Total Cost upfront:	**$37,400**

This means all Sharon requires upfront to control a $200,000 exposure in Berkshire Hathaway for three years is $37,400 and this is the maximum amount she can loose!

Potential returns

Assume Berkshire Hathaway can achieve an average return over the 3 years between March 2010 and October 2012 of approximately 20%pa[2].

Investment amount:	$200,000
Compounded at 20%pa, 3 years	$345,600
Gain	**$145,600**

Rate of Return (ROR)	**145,600/200,000**	**= 72.8%**
Return on Investment (ROI)	**((345,600 – 200,000) – 37,400)/37,400)**	**= 289%**

As you can see, when leverage is overlaid with capital protection, it creates an extremely powerful investment tool that can accelerate the long term performance of your portfolio, with minimal risk ñ the *holy grail* of investing.

If Berkshire Hathaway share price declines in value the maximum risk Sharon faces within super is the $37,400 paid upfront.

To ensure you understand the risk lets assume this time Berkshire Hathaway falls by 20% per annum for the three year period.

2 See letter to the shareholders 2010

Invested Amount:	$200,000
Compounded fall of 20%pa, 3 years	$102,400
Loss	**$37,400**

If Berkshire Hathaway falls by almost 50% over the three years as described above the investment amount would be worth only $102,400 yet a loan remains outstanding for $200,000. A terrible situation to be in if you did not have insurance on your investment.

As you held capital protection and because the loan was provided on a limited recourse basis the maximum amount Sharon can lose is capped at the upfront outlay being 37,400 or 6.3% pa. This Is the Interest expense and foreign currency hedging fee. This is not a good result however, because Sharon held insurance the loss is limited to $37,400 as apposed to $135,000 had she invested in Berkshire Hathaway without insurance and still borrowed.

Again we have proved you can enjoy all the upside potential of growth assets, without the high risks associated.

Even with leverage your downside risk is limited to the upfront expense.

As discussed previously, your superannuation portfolio should consist of no more than five and no less than three different companies, this same focused investment philosophy applies to structured investments. By adopting a concentrated portfolio, we aim to maximise returns by eliminating the poorly performing investments (by utilising capital protection) and holding on to the investments that are performing the best.

Investment decisions should be based on an individuals own goals, time horizon and tolerance for risk. You should seek professional investment advice prior to investing.

Growth in structured Investments is expected to be huge in Australia over the coming few years as more Australians become aware of their existence. They potential benefits exceed ordinary managed funds so it is not surprising to see structured investments being the fastest growing investment product in the world today.

Chapter Summary

- Structured investments provide an alternative method of investing with capital protection, compared to the traditional put option approach that is limited by numerous factors
- The structured investment market in Australia is increasing dramatically over recent years, and is biggest in Europe
- It is possible to borrow up to 100% of the investment amount, on a limited recourse basis, thereby maximizing returns, minimising risk and allowing you to walk away...*The Holy Grail of Investments*
- Structured investments can be tailored to have six key risk reduction mechanisms embedded in them
- Investment risk can be easily quantified at the outset of the investment
- Structured investments allow access to asset classes inaccessible in the general market place, providing an excellent solution for portfolio diversification.

Buffett fan's plan for Oracle fund

- **Michael Bennet**
- From: **The Australian**
- February 17, 2010 12:00AM

JB Capital CEO Justin Beeton.
Source: The Australian

BILLIONAIRE investor Warren Buffett has had no shortage of fund managers attempt to imitate his strategies.

But why try to replicate when you can invest directly in the "Oracle of Omaha" via his company Berkshire Hathaway, argues JB Global chief executive Justin Beeton.

Mr Beeton, a fan of Mr Buffett since the age of 14, will next week launch a new fund through his Sydney-based investment house to solely invest in the billionaire's New York Stock Exchange-listed company.

JB is looking to raise at least $40 million by the end of next month to cover costs after Mr Beeton and fellow staff kicked in the initial minimum of $10m.

Mr Beeton expects the JB Global Berkshire Hathaway Income & Equity Accelerator fund to be more popular than the company's other fund -- an ASX 200 vehicle in its fourth series -- that recently raised $120m.

"I've spoken to a few financial planners that we deal with and they're all extremely keen as it's the first time their clients can gain exposure to Buffett without currency risk and -- just in case the bloke dies -- any capital risk," Mr Beeton said.

Berkshire's A-class shares trade at about $US115,000 ($128,417) a share, but Mr Buffett late last month split the company's B-class shares, also known as "Baby Bs", 50 to one to make them more accessible to retail investors.

It is these more liquid Baby B's, which trade around $US75, that JB plans to invest in through tailored over-the-counter options.

Mr Beeton, who formerly worked in capital protection at Macquarie, said the fund would give retail investors access to an investment normally out of reach and have capital protection measures built in.

"In the past I've probably fallen victim, like the majority of fund managers who try to replicate Warren Buffett, but why try and replicate when I can buy his shares and get the same deals he does?" he said. "Berkshire Hathaway hasn't gone up anywhere near as much as its portfolio has so I believe it's trading well below its intrinsic value."

Investors can borrow 100 per cent of a minimum of $50,000 through a non-recourse loan facility provided by Royal Bank of Scotland, with $7500 in pre-paid interest to be paid up-front.

Mr Beeton said the loans would be capital protected by Merrill Lynch, the fund would be re-weighted to cash when volatility was high and redemptions paid out in Australian dollars to reduce currency risk. "It's huge leverage, you're talking 100 per cent leverage, which gives you a lot of upside and because of the capital protection, you don't get the negative," he said.

In return, JB will take a 1 per cent up-front fee of the total funds under management and a 10 per cent performance fee.

"We don't think our clients mind paying when we're providing performance. With no real performance I can't really justify any fees because I've added no value," he said.

JB plans to launch a similar fund to invest in Chinese infrastructure and property in June.

"Throughout Asia I think the best allocation of capital is in that space," he said.

Australian Financial Review 17 February 2010

Managers face tough competition

David Ciampa

Fund managers may be a bit more nervous in coming weeks but it won't be because of the uncertain economic outlook or falling share prices.

From next week local money managers will be pitted against Warren Buffett as Australian investors take a position in the portfolio of the world's most famous sharemarket guru.

Sydney-based financial services company JB Global will be tapping investors, launching a capital-protected product enabling investors to leverage into Buffett's lBerkshire Hathaway fund.

While Berkshire Hathaway A-class shares trade at the prohibitive levels of about $US115,000 ($129,420) a share, Justin Beeton, chief executive of JB Global, says the product links Berkshire's B-class shares, which fetch a less daunting $US75, following a series of share splits.

"A lot of fund managers have tried to replicate Buffett's investment philosophy, but in my view why replicate it when you can just buy the stock", Mr Beeton said.

"Fund managers don't want to do that because they will make themselves redundant."

JB Global has set up the product to allow shareholders to borrow full face value of an investment at 4.95 per cent p.a. for three years, which compares favourably with Berkshire Hathaway's long-term average of returns.

Berkshire's growth by 20.3 per cent a year to its shareholders for the past 44 years may make Australian fund managers a little nervous, given the Australian sharemarket has generated an average annual return of 14.9 per cent over since 1980 – including dividends. However, Buffett's general buy-and-hold approach doesn't include paying dividends to shareholders, which might take some time for Australian investors to get used to. Investment in the fund opens on February 22 and closes on March 31.

10 businessday.com.au

THE AGE
Thursday, February 25, 2010

Trading Room

Rare chance for Australians to grab on to Buffett coat-tails

LUCY BATTERSBY
DERIVATIVES

A SYDNEY fund manager has found a way to give Australian investors access to the most famous fund manager in the world — Warren Buffett.

The Berkshire Hathaway Income and Equity Accelerator, released this week by JB Global investment services, gives Australians direct exposure to Berkshire Hathaway B-class shares without actually owning them.

"The average annual return [from Berkshire Hathaway] over the last 50 years has been 20.3 per cent," said JB Global chief executive Justin Beeton.

"The big returns in Berkshire Hathaway have happened during periods following a crisis. Buffett has said that [events] like the global financial crisis give him an opportunity to spend his cash wisely.

"So following the GFC is a great opportunity to grab on to his coat-tails."

Normally, if an Australian wanted to be part of the Berkshire Hathaway fund, they would have to convert money to US dollars and buy the shares through the New York Stock Exchange.

There are two types of Berkshire Hathaway shares — class-A shares, which cost $US118,400 ($A131,850) each, and the more common class-B shares, which cost $US79.15 each. JB Global's product focuses solely on class-B shares, because they are more affordable and easily available.

With this product, 80¢ of every dollar put into a three-year non-recourse loan issued by RBS turns into a bond to ensure investors receive some kind of return regardless of how Buffett's fund performs. "Non-recourse" means the borrower is not liable to pay back the loan if the lender fails. The remaining 20¢ goes to a call option designed by the investment bank specifically for JB Global for this purpose, and will provide returns commensurate with the class-B shares' growth or decline.

"Any growth in Berkshire Hathaway will be replicated in the option as if the full dollar is invested in the underlying asset," Beeton told BusinessDay. The investment also provides an 8.1 per cent annual income.

Investors must buy at least 100,000 units, costing $100,000, and can borrow the full amount if they pre-pay $14,850, representing three years of 4.95 per cent interest.

"The investment is 100 per cent capital protected through a non-recourse loan, meaning even if Buffett dies and the share price of class-B shares depreciates the investor can only lose the interest expense," Beeton said.

When the investment is redeemed, the investor realises the gains or loss in the Berkshire Hathaway share.

FINANCIAL REVIEW
PORTFOLIO

Wednesday 3 March 2010

Edited by: spatten@afr.com.au

Why replicate success when you can buy into it

A new product allows Australians to buy directly into Berkshire Hathaway, writes **David Ciampa**.

If a gloomy economic outlook and a bad start to year on the sharemarket weren't enough for Australian fund managers, the local money management game has just become a little more competitive.

Australian investors now have the opportunity to make a play in Berkshire Hathaway – the US-listed fund of legendary investor Warren Buffett, leaving local fundies to look over their collective shoulder.

Sydney-based financial services company JB Global will be tapping investors over the next month as it launches its latest capital-protected product enabling investors to leverage into Buffett's Berkshire Hathaway fund.

While Berkshire Hathaway A-class shares trade at the prohibitive levels of about $US115,000 ($129,420) a share, the capital-protected product tracks Berkshire's B-class shares, known affectionately as baby-Bs, which fetch a less daunting $US75 a share, following a series of share splits.

JB Global, which raised $120 million last year for JB's S&P/ASX 200 linked product, has teamed up with Royal Bank of Scotland and Merrill Lynch to create the new Berkshire Hathaway Income and Equity Accelerator.

JB Global chief executive Justin Beeton says that a lot of Australian fund managers may feel threatened by his latest product offering.

"A lot of fund managers have tried to replicate Buffett's investment philosophy, but in my view, why replicate it when you can just buy the stock," Beeton says.

"Fund managers don't want to do that because they will make themselves redundant."

Warren Buffett . . . many have tried to copy his philosophy. Photo: BLOOMBERG

JB Global has set up the product to allow shareholders to borrow full face value of an investment at 4.95 per cent a year for three years.

Berkshire's history of growing by an average of 20.3 per cent a year for the past 44 years may make Australian fund managers a little nervous, given the Australian sharemarket has generated an average annual return of just 14.9 per cent since 1980, which includes dividends.

However, Buffett's general buy-and-hold approach doesn't include paying dividends to shareholders, which might take some time for Australian investors to get used to.

The product invests a small portion – about 20 per cent – of every dollar into a 1-for-5 call option on the Berkshire's stock, while JB Global offsets downside risk by using the rest, about 80 per cent, in a three-year non-recourse loan issued by RBS, which turn into bonds.

Beeton says the bonds, which pay a 6 per cent annual return, guarantee the face value of the investment at the three-year maturity, ensuring that investors can, at worst, walk away after three years without losing their initial investment.

This differs from traditional long-only managed funds that fall in value when asset prices decline.

But at the other end of the spectrum, Beeton says investors may pocket up to a 60 per cent gross return over the three years based on Berkshire's performance history. The product is leveraged to the performance of Berkshire shares through a 1-for-5 call option, which means that if Berkshire shares rise by 20 per cent, the call option will double in value. The bond investment also provides an 8.1 per cent annual income.

Usually, an Australian investor seeking to buy the Berkshire Hathaway fund would have to convert money to US dollars and buy the shares through the New York Stock Exchange, but JB's product mitigates currency risk.

The minimum investment with JB Global's product is 100,000 units, costing $100,000; investors can borrow the full amount if they pre-pay $14,850, representing three years of 4.95 per cent interest.

"Even if Buffett dies and the share price of class-B shares depreciates, the investor can only lose the interest expense," says Beeton.

Investment in the fund closes on March 31, but Beeton says that there is likely to be another offer to be opened in June.

JB Global offers access to Warren Buffett

Written by Darin Tyson-Chan

JB Global Investment Services has launched a capital protected managed fund giving investors access to global fund manager Berkshire Hathaway, chaired by Warren Buffett.

The managed fund was designed to be suitable for SMSF investors.

The SMSF focus of the JB Global Income and Equity Accelerator Berkshire Hathaway Series comes in the form of the fund's gearing structures, whereby a non-recourse loan is offered to investors to assist them in raising the capital required to participate in the fund.

Merrill Lynch and Royal Bank of Scotland will be providing the gearing facility. In line with the *Superannuation Industry Supervision (SIS) Act*, units in the fund acquired through the gearing structure will be held in trust until maturity.

Individuals can borrow up to 100 per cent of the investment in the fund. At maturity, the loan can either be paid off separately or the investor can choose to sell off the units in the managed fund to satisfy the loan while retaining any residual capital growth.

Interest on the gearing will be paid upfront by investors.

"The downside of the investment, if it all does go pear-shaped, is 4.95 per cent per annum but you still get all of the upside," JB Global managing director Justin Beeton said.

Unlike other global funds, the underlying asset in the JB Global offering will consist only of an investment in Berkshire Hathaway.

"There is only one stock, but within that stock there is a little diversification made up of the different companies Buffet wants to hold," Beeton said.

Minimum investment in the fund is $50,000. "Normally, to get exposure to Buffett's stocks investors have to either buy the A or the B shares that are US$90,000 and US$3000, so that's a fair outlay," Beeton said.

The maturity term for the capital protection on the fund investment is three years, with quarterly redemptions available. Currency movements are hedged.

Beeton said the fund was looking to generate income of up to 7.2 per cent each year plus capital growth.

The fund is open now and set to close on 31 March.

Jusitn Beeton
JB GLOBAL

More Examples

To recap, The JB Way investment philosophy involves four steps:

Step 1 – Adopt a focused investment philosophy similar to Warren Buffett to hopefully maximise returns.

Step 2 – Put the bulk of your funds in those companies.

Step 3 – Reduce risk by buying insurance.

Step 4 – Use the dividend income (if dividends are paid) to offset some of the premium paid for the insurance premium.

While past performance is not a guarantee of future performance the following examples have been included to ensure you know both sides of the equation. Without knowing the maximum risks when analysing an investment you cannot make a fully informed decision. These examples are just some of the companies purchased following this investment philosophy since 2004.

The examples do not include tax or transaction costs. When these are included the outcome may differ from the results excluding these costs. You should consult a licensed investment adviser prior to investing.

So, what happened when the share market fell over 50% as a result of the GFC?

Suncorp Metway – SUN

SUN – 29th Mar 2007	
Purchased 2,000 shares at $20.34	($40,680)
Purchased 2 SUN put options expiring in Mar 2008 with a strike price of $20.34	($3,400)
Total outlay	**$44,080**

By combining a share investment in SUN with insurance, the investor reduced the downside risk on $40,680 worth of SUN shares to $3,400.

This would have been the maximum loss if the SUN share price fell in value and paid no dividend income. That is, the risk was limited to 8.4% of the total amount invested.

Prior to the expiry of the put options the SUN share price had fallen to $13.17. At $13.17, most investors or those investors following the traditional buy and hold strategy would have lost over 27% when taking into consideration the capital loss on the share and the dividends they were entitled to during this period. However, due to the investor having insurance on their shares following The JB Way the loss was limited to $340 or 0.8%.

SUN paid a total dividend of $1.53 or $3,060 for the 2,000 shares held. This dividend income reduced the loss on the investment to $340 or less than 1% of their total outlay.

Zinifex – ZFX

ZFX – 26th October 2007	
Purchased 3,000 shares at $18.00	($54,000)
Purchased 3 ZFX put options expiring in June 2008 with a strike price of $18.00	($7,830)
Total outlay	**$61,830**

This investment in Zinifex occurred almost at the peak of the market in 2007.

By combining a share investment in ZFX with insurance the investor reduced the downside risk on $54,000 worth of ZFX shares to $7,830.

Again this was the premium paid for the put options.

The premium paid for the put options for ZFX was high, however, the total dividend was also expected to be high to offset the majority of this cost. The problem was that it was not just the share price that fell in value but the company also reduced their dividend. If the dividend is reduced the investor loss will be the premium paid for the put options. This is why we buy a minimum of three different companies from different sectors to hopefully minimise the risk of all three companies reducing their dividend at the same time.

ZFX was expected to pay a dividend of over $2.50, however this was reduced to $1.50 per share for the protected period.

At the expiry of the put option contracts the ZFX share price had fallen to $8.72.

Thankfully the investor had insurance. By having insurance the majority of their investment capital was protected when the market declined.

At $8.72 if the investor did not have insurance the loss would be approximately 43% calculated from the capital loss on the share price and the dividends they received during this period. However, by having insurance the actual loss was reduced to $3,330 or just 5.3%.

Investment success has nothing to do with how much money you make, but to do with how much money you keep.

Late 2008, Zinifex merged with Oxiana meaning ZFX investors had their shares exchanged for new shares in the combined entity. The combined company became OZL. At the time of writing this book, OZL shares were trading at approximately $1.00. The company appears to be another casualty of the global financial crisis and again another reminder why all Australians should buy insurance on their share market investments.

Those investors who held put options over their ZFX shares exercised their right to sell their shares at their protected price and received their initial capital investment back. That is, as the shares were protected at $18.00 per share the investor was paid $18.00 by the ASX under the normal three-day settlement process.

Wesfarmers – WES

WES – 19th July 2007	
Purchased 1,000 shares at $41.00	$41,000
Purchased 1 WES put option expiring in Mar 2008 with a strike price of $41.00	$3,390
Total outlay	**$44,390**

By combining a share investment in WES with insurance the investor reduced the downside risk on $41,000 worth of WES shares to $3,390 or 7.6% of their total outlay. Again, this risk was the premium paid for the put option.

WES paid a total dividend of $2.92 per share or $2,920 for the 1,000 shares held throughout the protected period.

At the expiry of the put option, the WES share price had fallen to $37.75 or 7.93%.

At $37.75, if the investor had just purchased the shares without capital protection (following the traditional buy/hold strategy), the investor would have lost $330 when including the dividends was paid. By having insurance the loss was actually a little more being $470.

Some investors argue that you only lose money when you sell shares. That is, when the share price falls you can hold for the long-term hoping the share price will increase over time. At the time of writing this book, if the investor followed this traditional buy and hold approach and did not sell the WES shares at $37.75, and did not take the 7.93% loss, that same investor would now be down over 65% as the WES share price has fallen significantly further. The same thing would have occurred with ZFX, as the ZFX share price has fallen over 90%.

Total portfolio results

By having insurance on their share investments, the investor could comfortably adopt the focused investment philosophy like Warren Buffett in an attempt to maximise returns. The put options gave the investor the peace of mind that if the three companies share price did fall in value, their entire investment would not be eroded.

Throughout late 2007 and 2008, the share market collapsed around the globe and these three companies used in these examples were not isolated from the decline. If you held these three companies the portfolio fell 28.46% in what many economists have described as the worst economic environment since the 1930s.

Thankfully, the investor had the foresight to invest in put options to protect their investment. For the combined portfolio of $150,300 described above the total loss was $4,140, or 2.75%.

I know this is not a gain, however, if the funds were invested in a normal balanced fund the loss would have been almost 30%. When the markets around the globe fell by more than 50% in many instances the JB Way ensured the majority of the investor's investment capital was safe from the market crash.

So what happens when the share price increased in value?

Onesteel – OST

OST – 25th November 2004	
Purchased 20,000 shares at $2.50	($50,000)
Purchased 20 OST put options expiring in August 2005 with a strike price of $2.50	($3,200)
Total outlay	**$53,200**

By combining a share investment in OST with insurance, the investor reduced the downside risk on $50,000 worth of OST shares to $3,200. The maximum risk was therefore 6.01%. Again this was the initial premium paid for the put options contract.

OST paid a total dividend of $0.0857 per share or $1,714 for the 20,000 shares held.

Prior to the expiry of the put options the OST share price traded at $3.35.

At $3.35 the investor has made $15,514 profit or 29.16% in just eight months.

As the share price was above the initial protected price we did not sell but bought further put options to lock in the gains.

OST share price had increased from $2.50 to over $7.00 throughout the entire holding period. At the expiry of the put options, when the share price was above the protected price, we simply purchased more put options to lock in the gains and to further extend the protected period as shown below.

Figure 10.1 – OST Share price history

Eventually the investor that had the foresight to have put options to protect their shares sold the 20,000 shares at $7.00 by exercising their right to do so through the put options held, even though the share price was trading at $2.50 at the time of the sale. This is a spectacular gain as their initial $50,000 investment increased to $140,000.

This is a return of 180% in approximately four years.

Investors following the traditional buy and hold approach would have seen all their gains eroded when the share price fell in 2008.

Cochlear – COH

COH – 17th August 2004	
Purchased 2,000 shares at $20.00	($40,000)
Purchased 2 COH put options expiring in Feb 2005 with a strike price of $20.00	($3,400)
Total Outlay	**$43,400**

By combining a share investment in COH with insurance the investor reduced the downside risk on $40,000 worth of COH shares to $3,400 or 7.83%. Again, this risk was the premium paid for the put options.

COH paid a total dividend of $1.13 per share or $2,260 for the 2,000 shares held over the initial protected period.

Prior to the initial put options expiry the COH share price traded at $31.10.

At $31.10 the investor made $21,060 or 48.52% over the initial 7-month protected period.

At this price we did not sell but bought further put options to lock in the gains and to extend the protected period.

COH share price had increased from $20.00 to almost $80.00 from 2004 to late 2007. Most patient investors had the opportunity to lock in gains at $72.00. Therefore, when the share price fell back to below $48.00 in 2008, investors that held put options to insure their shares could sell their shares at the higher protected price ($72.00) thereby making a significant gain.

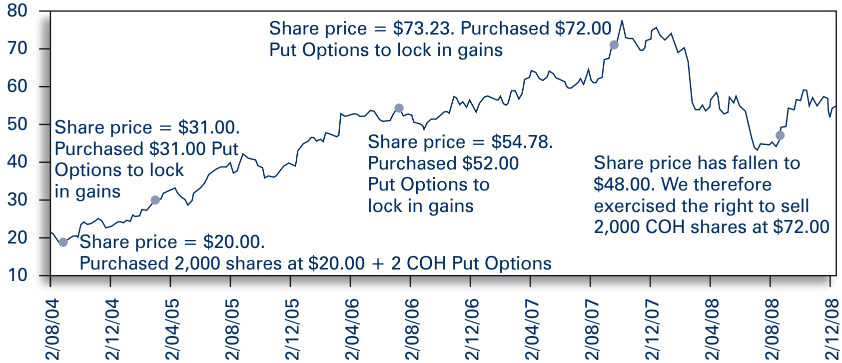


Figure 10.2 – COH share price history

Investors could sell their COH shares for $144,000 from an initial investment of $40,000. A 260% gain over a four-year period.

You do not need to take high risks to achieve spectacular returns.

Macquarie Airports – MAP

MAP – 6th May 2004	
Purchased 25,000 shares at $1.80	($45,000)
Purchased 25 MAP put options expiring in June 2005 with a strike price of $1.80	($6,250)
Total outlay	**$51,250**

By combining a share investment in MAP with insurance the investor reduced the downside risk on $45,000 worth of MAP shares to $6,250. While the premium paid was relatively high being almost 14% of the purchase price, the investor received three dividends throughout the protected period.

MAP paid a total dividend of $0.23 per share or $5,750 for the 25,000 shares held.

At the expiry of the put options the MAP share price traded at $3.47.

At $3.47 the investor has made a capital gain of $1.67 or 81.46%. This was achieved with a maximum risk of 12.19% on the client's total outlay.

As the share price was well above the initial protected price we did not sell but bought further put options to lock in the gains.

MAP share price increased from $1.80 to over $4.50 over the next few years. At the expiry of the put options, when the share price was above the protected price we simply purchased more put options to lock in the gains and to further extend the protected period as shown below.

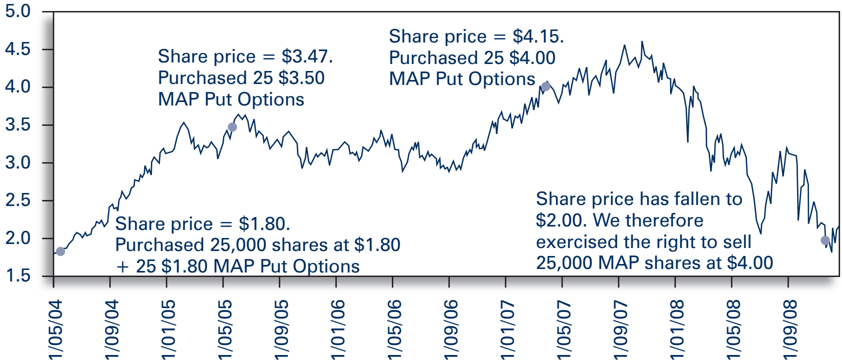


Figure 10.3 – MAP share price history

Eventually the investor sold their 25,000 shares at $4.00 by exercising their right to do so through the put options held, even though the share price was trading at less than $2 at the time of the sale. This is a spectacular gain as their initial $45,000 investment increased to $100,000.

Investors following the traditional buy and hold approach would have seen all their gains eroded when the share price fell in 2008.

Example – AMP

AMP – 7th July 2005	
Purchased 5,000 shares at $6.50	$32,500
Purchased five AMP put options expiring in March 2006 with a strike price of $6.50	$2,575
Total investment	**$35,075**

By combining a share investment in AMP with insurance via put options, the investor has reduced the downside risk on $32,500 worth of AMP shares to $2,575. This $2,575 was the premium paid for the put options.

Prior to the expiry of the put options, the AMP share price traded at $8.68 – an increase of 33.5%.

At \$8.68 per share, when including dividends received the investor made \$10,440 profit with a maximum risk of \$2,575. This is a return of almost 30% on the initial investment with very little risk.

Note AMP paid a special dividend during the holding period. Under such circumstances, the ASX has the capacity to change the specifications of the put option contract to ensure both the buyer and seller of the option is not disadvantaged by such corporate activity. The strike price of the put option was reduced to \$6.36 and the number of shares per contract size was increased to 1,039. As the special dividend paid was \$0.40, these adjustments did not have a negative impact on the risk of the investment. As the share price at maturity of the put option contract was above the strike price, the investors' profit was \$2,000 higher because of the special dividend.

Santos – STO

STO – 12th December 2006	
Purchased 5,000 shares at \$9.60	(\$48,000)
Purchased 5 STO put options expiring in March 2008 with a strike price of \$9.50	(\$5,850)
Total outlay	**\$53,850**

By combining a share investment in STO with insurance the investor reduced the downside risk on \$48,000 worth of STO shares to \$6,350 or 11.8%. As the STO shares were purchased at \$9.60, and the put options had a strike price of \$9.50 the investors loss if the share price fell below the protected price would be the premium paid for the put options plus the \$0.10 per share difference between the purchase price and the protected price. That is, the investor would be self insured for \$500 in total. This could be similar to the excess that you pay on your car insurance if you make a claim.

STO paid a total dividend of \$0.86 per share throughout the initial protected period or \$4,300 for the 5,000 shares held.

Prior to the expiry of the put options, the STO share price traded at \$14.50.

At \$14.50 the investor made a \$22,950 profit or a 42.6% return. This was with a maximum risk of \$6,350.

At this price we would not sell but buy further put options to lock in the gains and to extend the protected period.

The shares were initially purchased at $9.60. The investor eventually locked in gains at $19.00. The share price did trade above $21.00, however at the expiry of the protected period the share price had fallen back to under $13.00. The investor had the right to sell the shares at $19.00. At $19.00 the share price has increased by almost 100%. This means the investor has almost doubled their investment over the holding period when the maximum amount they could have lost was 11.8%.

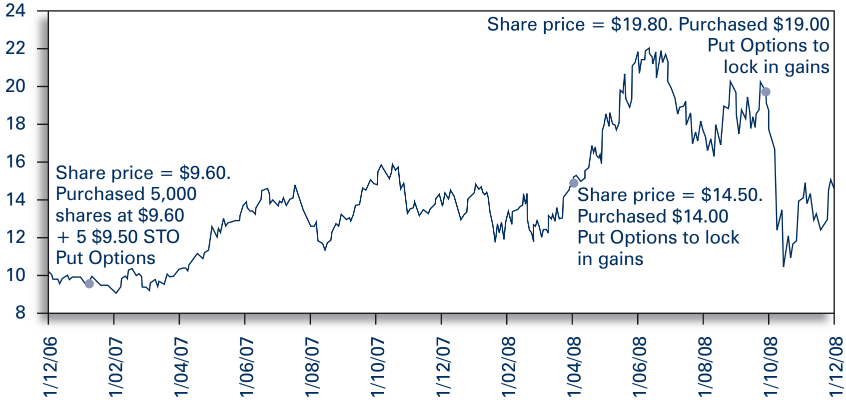


Figure 10.5 – STO share price history

Following this investment philosophy is the only way you can buy close to the bottom and sell very close to the top. The latter is achieved because we have the benefit of hindsight.

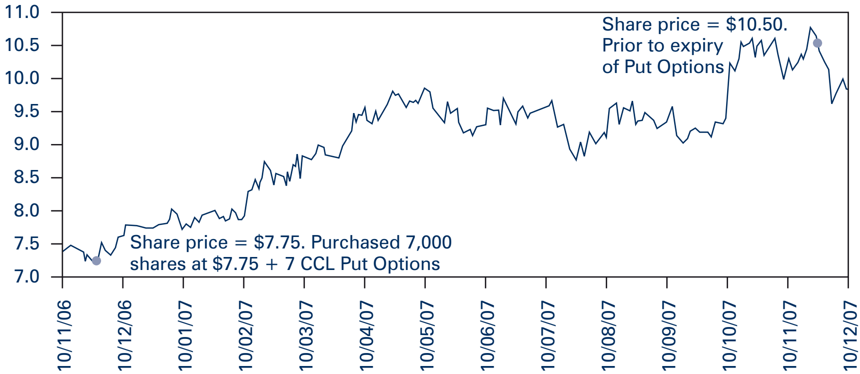
Coca Cola Amatil – CCL

CCL – December 2006	
Purchased 7,000 shares at $7.75	($54,250)
Purchased 7 CCL put options expiring in Dec 2007 with a strike price of $7.75	($3,080)
Total outlay	**$57,330**

By combining a share investment in CCL with insurance the investor reduced the downside risk on $54,250 worth of CCL shares to $3,080 or 5.67%.

CCL paid a total dividend of $0.47 per share throughout the initial protected period or $3,290 for the 7,000 shares held.

Prior to the expiry of the put options, the CCL share price traded at $10.50.



At $10.50 the investor made a total profit of $19,460 or a 34% return. This was with a maximum risk of $3,080.

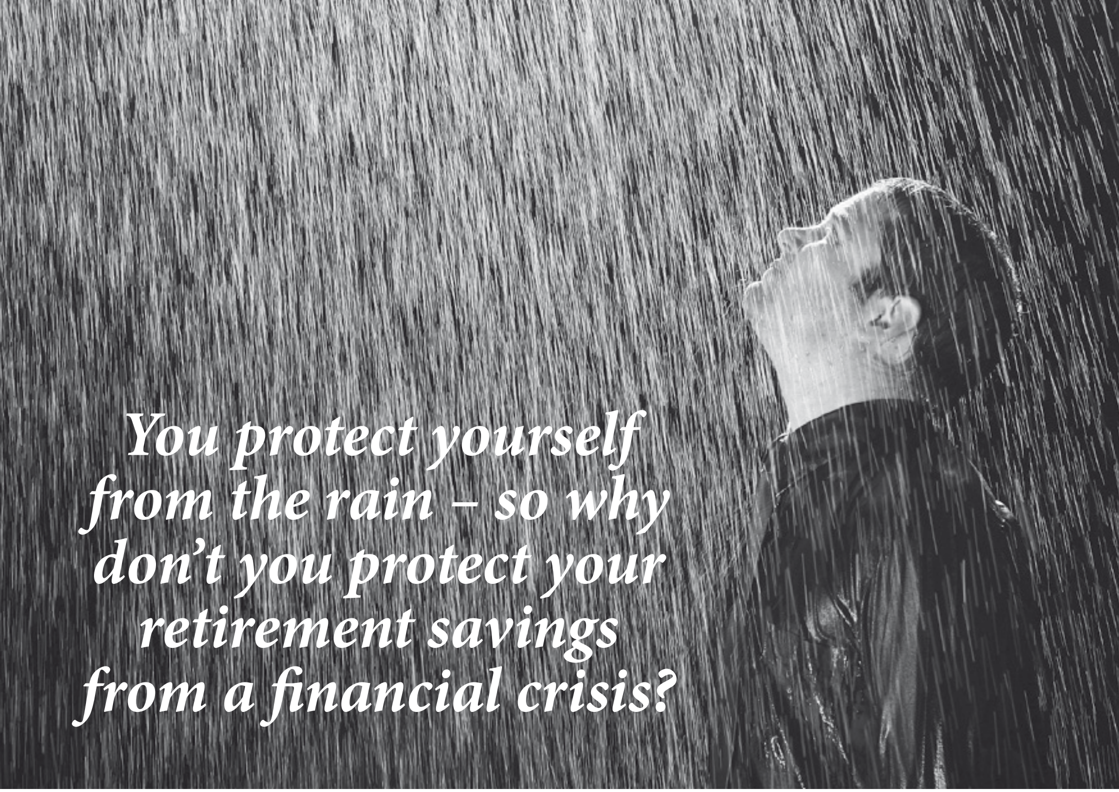
Moving forward

These examples described above have been chosen to give you an idea of what the likely outcome could be by implementing the JB Way investment philosophy. I have been implementing the investment philosophy for almost the last decade and each and every year I have outperformed the market both personally and for my clients. That is, I have provided a higher return to clients in the years the market has increased, many times this outperformance has been significant and for the years the market actually fell in value (2008) the loss was minimal as I held insurance!

As the share price of the majority of the companies used in these examples have fallen significantly with the general market (some have fallen even further than the general market), the investors now have the opportunity to roll down the positions by buying more shares at lower prices – when the share price falls you have the opportunity to make shares. The investor should only buy back into a company if they believe that share represents the best allocation of their capital – if not simply buy the share that offers greater potential.

"Profit from market folly rather than participate in it"

Warren Buffett


You protect yourself from the rain – so why don't you protect your retirement savings from a financial crisis?

When the market falls we are reminded as to the critical importance of having insurance and protecting your investment from a market crash.

Unfortunately, throughout late 2007, 2008, and early 2009 share markets across the globe crashed as a result of the global financial crisis as fear griped even professional investors.

The Australian share market fell over 50% from the previous highs in approximately 16 months. This fall and the drop in property prices during this period together wiped over $300 billion off the total superannuation pool in Australia alone.

This simple, safe, and successful investment philosophy is in fact designed for these times. This is why we buy insurance.

We buy insurance to protect our lifetime savings, whether they are in our own name or superannuation, from a market crash. And markets across the globe certainly did crash as a result of the global financial crisis. The Dow Jones fell over 40%; the Chinese stock market fell over 60%, Japan's Nikkei over 65%, London down over 40%, and Russia down over 70%.

Many investors around the globe wished they had insurance throughout this crisis.

This is definitely the case for many investors who were approaching retirement where their superannuation funds have declined significantly meaning those investors must either work longer or reduce their standard of living in retirement. If only these people understood the importance of insuring their superannuation. If only these people knew you could buy insurance on shares.

The shares in 2007/2008 were no different to the general market as they depreciated in value significantly. However, as we had insurance the loss was very small in comparison.

By buying insurance, you can protect your lifetime savings from a share price decline.

Warren Buffett's rules to investing:

Rule Number 1: Never lose money.

Rule Number 2: Never forget rule number 1.

According to modern investment theory that an investment that involves low risk usually only offers low returns. Modern investment theory suggests that returns are directly correlated to the risk associated.

If modern investment theory is correct, then because the JB Way protected the majority of investors capital when the global share markets plummeted throughout a period which many economists have described as the worst economic period since the 1930s then the returns when the market increases should also be significantly lower.

This would be the case if modern investment theory was still valid, however, the JB Way proves modern investment theory is outdates as the returns when the market increased was again a lot higher than the market.

Summary:

- There is only one guarantee on the share market and that is you will own shares that rise in value and shares that fall in value.
- When the market falls we are reminded as to the critical importance of having insurance and protecting your life time savings from a market crash.
- When the shares you buy rises you enjoy the majority of the profit potential.
- This investment strategy proves modern investment theory is wrong. You do not need to take on high risks to enjoy high returns.
- These examples do not include tax or transaction costs. When these costs are included the end result will be different.

All profits generated from the sale of *The JB Way* go directly to the Bear Cottage.

Bear Cottage is a place where children with terminal illnesses and their families can stay from time to time and receive rest and medical care in a home-like environment.

With specialist medical care available 24 hours a day to take care of the children's medical needs and staff and volunteers to see to daily tasks such as cooking and cleaning, families are provided with the opportunity to spend some quality time together while dealing with terminal illness.

In addition to providing respite and end of life care, Bear Cottage runs a number of other programs aimed to support the entire family. Bear Cottage not only affirms the quality of life of our sickest children, it also affirms the quality of life of their families.

Families do not pay for any Bear Cottage services and all operating expenses are raised entirely through community donations.

Bear Cottage was established entirely by the community and continues to rely on the community for funding.

They receive no government funding, the uniquely compassionate services, facilities and atmosphere of Bear Cottage are a testament to the power of community. By dedicating their time, effort and financial assistance, volunteers and donors ensure that Bear Cottage is able to continue to give the very best in care and support to families in need.

To find out more about Bear Cottage go to www.bearcottage.chw.edu.au

JB Global is a *leading financial services* firm that gives the investor a *customised proven strategy* that *protects your current wealth so you can "sleep at night"* if share markets fall, while *maximising your investment returns when the market rises* giving you and your family the *lifestyle you want in the future.*

JB Global Investment Services was established in December 2004, as a privately-owned Australian investment services firm. JB Global has offices across Australia and in 2007 was ranked in the BRW magazine as the number one fastest growing investment services company.

JB Global's commitment to outstanding performance, client service and education make it one of the leading investment services companies in Australia.

What we stand for

"meum pactum dictum" – my word is my bond

- Maximising client wealth
- Commitment to service
- Educating our clients
- Developing market leading investment strategies

JB Global Premium Portfolio Service

If you would like to invest following *The JB Way* investment philosophy, the actual name of the investment strategy is the JB Global Premium Portfolio Service.

JB Global Premium Portfolio Service [PPS] is specifically tailored for investors who desire high growth potential from their investments. JB Global PPS is also designed for investors who have worked hard to accumulate their wealth and therefore also desire low risk.

JB Global PPS involves a *focussed* investment philosophy similar to that adopted by Warren Buffett. By adopting a *focussed* investment philosophy, you have the potential to significantly outperform the market.

Through the purchase of insurance (put options), the risk of adopting such a concentrated investment is significantly reduced.

The benefits of the JB Global PPS are:-

HIGH GROWTH POTENTIAL

To ensure performance is maximised, JB Global PPS adopts a *focussed* investment philosophy similar to the proven strategy implemented by Warren Buffett. This gives you the potential to achieve high returns.

CAPITAL PROTECTION

Through the purchase of put options, the majority of your investment capital can be protected from a decrease in value. This protection can significantly limit your loss if your portfolio falls, whilst you still enjoy 100% of the upside profit potential when the market rises.

FULL SERVICE INVESTMENT ADVICE

JB Global believes ongoing full service investment advice involves more than the attention of one single adviser. JB Global PPS involves tailored advice from your Personal Adviser, combined with a team of professional Investment Managers who are looking for opportunities to ensure your returns are maximised.

CUSTOMISED TO YOUR INDIVIDUAL NEEDS

We customise your investment portfolio based on your individual financial circumstances, financial needs and investment goals. You maintain control, ownership and transparency throughout the life of your investments. Investments can be made in individual names, joint names, superannuation funds, companies or trusts.

LEVERAGE

Up to 100% leverage of the protected value of your investment can be obtained. When borrowing money to invest, there is the additional risk of funding the ongoing interest expense. Gearing levels can be adjusted to suit your individual circumstances and can be modified over time.

LIQUID & FLEXIBLE

Investment can be easily increased or decreased. Existing share holdings can be incorporated into the JB Global PPS. You can protect or release your equity for diversification benefits.

The steps involved for you to become a client of JB Global is to either register on our website at www.jbglobal.com.au or call for an appointment with a JB Global licensed Investment Adviser on 1300 522 644.

What you will learn

- What it takes to be a great investor
- How to maximise profits whilst minimising risk
- The psychology of successful investing from the worlds best
- The benefits of saving and compounding
- Warren Buffett's Investment Philosophy
- The right time to invest
- How to make smart investment decisions
- How to safely invest in shares
- How to protect your down side if you get it wrong
- Strategies that you can use to teach your kids to secure their financial success

And much much more...

“The JB Way has been instrumental in providing us with the get up and go to start our investment portfolio. Justin's advice and easy to follow step by step approach have reaped many rewards over the past two years. Now we measure each trade and decide the amount of risk involved and can make decisions with confidence.”

Scott and Samantha

“What does everyone want from an investment adviser? First and foremost we want honesty, integrity, leadership and a sense that our best interests are an absolute priority. After much searching I finally found Justin Beeton, who's service is always exemplary, easily accessible and my investment returns have matched the extraordinary goals I have set myself.”

Dr Greg

All proceeds from the sale of this book are donated to Bear Cottage
www.bearcottage.chw.edu.au

Justin Beeton is the Managing Director and founder of JB Global Investment Services.

Justin commenced his career in the stock broking industry in 2000. In this time he has built a substantial international client base uniquely assisting clients as both a teacher and adviser to novice and veteran investors.

Justin holds a Bachelor of Commerce Degree, has the highest possible derivatives accreditation, and has a post graduate degree in Applied Finance and Investment.

Justin's educational qualifications, personal experience and extensive research into creating unlimited wealth have led to Justin developing a portfolio of powerful and proven investment strategies. These strategies enable the investor to be exposed to the huge potential gains available through the share market whilst significantly reducing the risk.

Proudly sponsored by
JB Global Investment Services
www.jbglobal.com.au