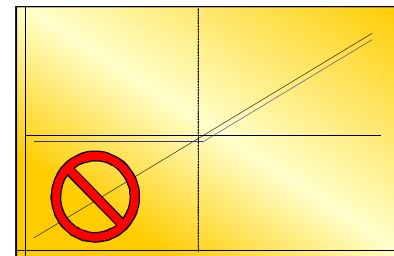
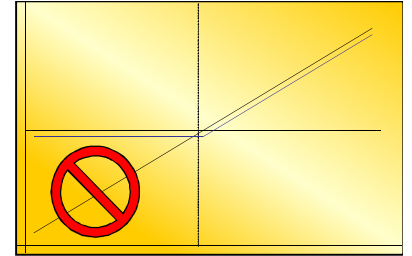


*Diversify!*

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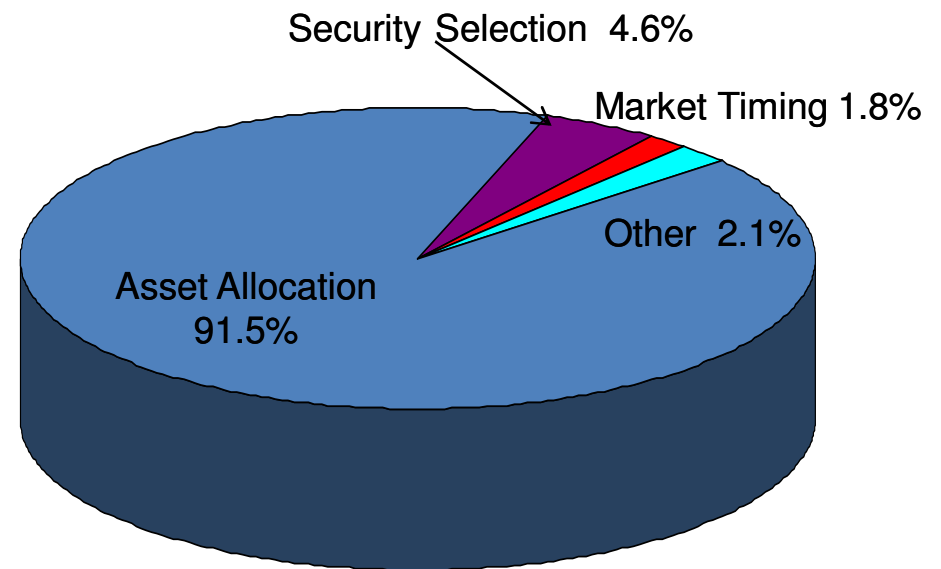


"My broker advises me to have the pork bellies."

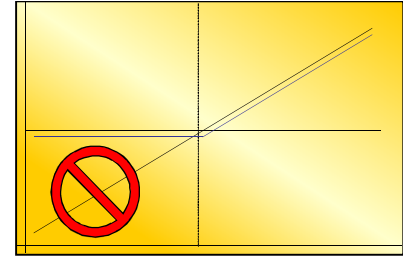


## Asset Allocation

In 1986, Brinson, Hood, and Beebower (BHB) published a study on the asset allocation of 91 large pension funds as measured from 1974 to 1983 “The study found that asset allocation was the overwhelming dominant contributor (91.5%) to the total return of an investment portfolio. Choosing the right stock or mutual fund was not the answer (4.6%), while market timing proved even more inept (1.8%). The dramatic results supported the notion that the asset allocation decision was the primary determinant of investment performance.”



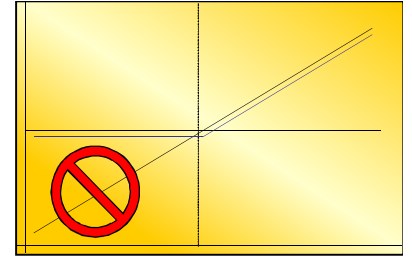
**Source: Brinson, Singer, and Beebower (1991) - Financial Analysts Journal, May/June 1991.**



## *Diversification Failed*

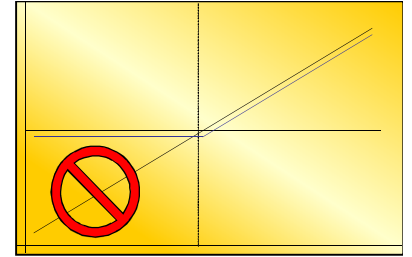
*“...In times of trouble, markets become more closely linked, and seemingly unrelated assets rise and fall in tandem”*

(David W Mullins, Partner, Long Term Capital Management; Lowenstein, 2000)



## ***Market Risk:***

The day-to-day potential for an investor to experience losses from fluctuations in securities prices. This risk cannot be diversified away. Also referred to as "*systematic risk*".

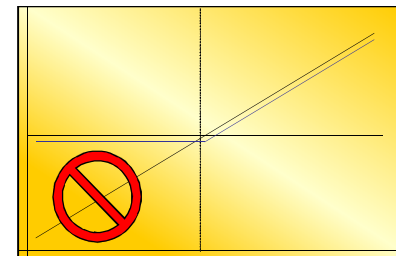


## ***Systematic Risk:***

Interest rates recession and wars all represent sources of systematic risk because they affect the entire market and cannot be avoided through diversification. Systematic risk can be mitigated only by being hedged.

# Diversification

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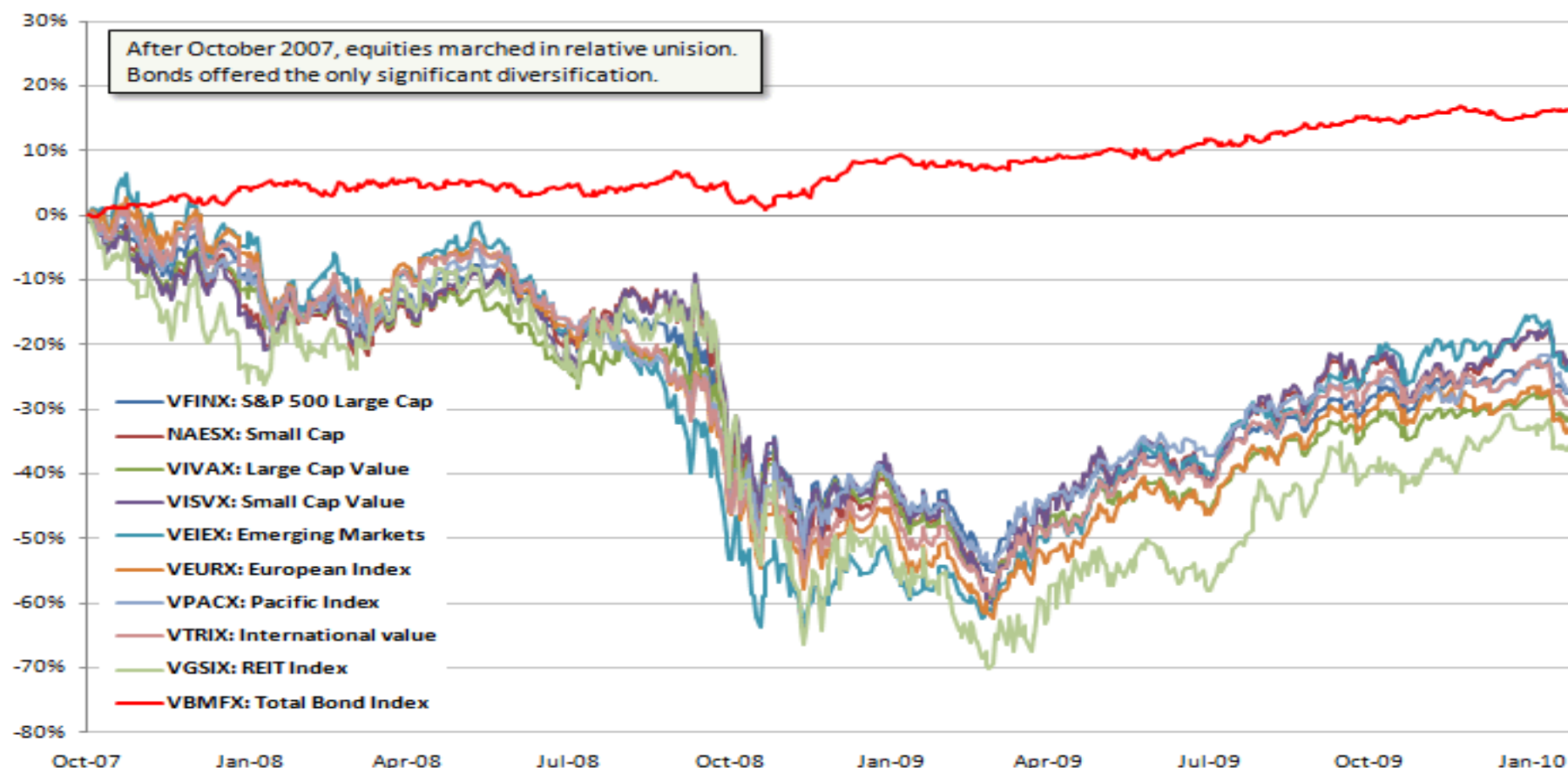


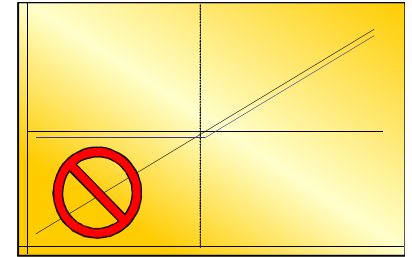
**... until it doesn't.**

dshort.com  
February 2010

**Asset Class Examples Using Vanguard Mutual Funds**

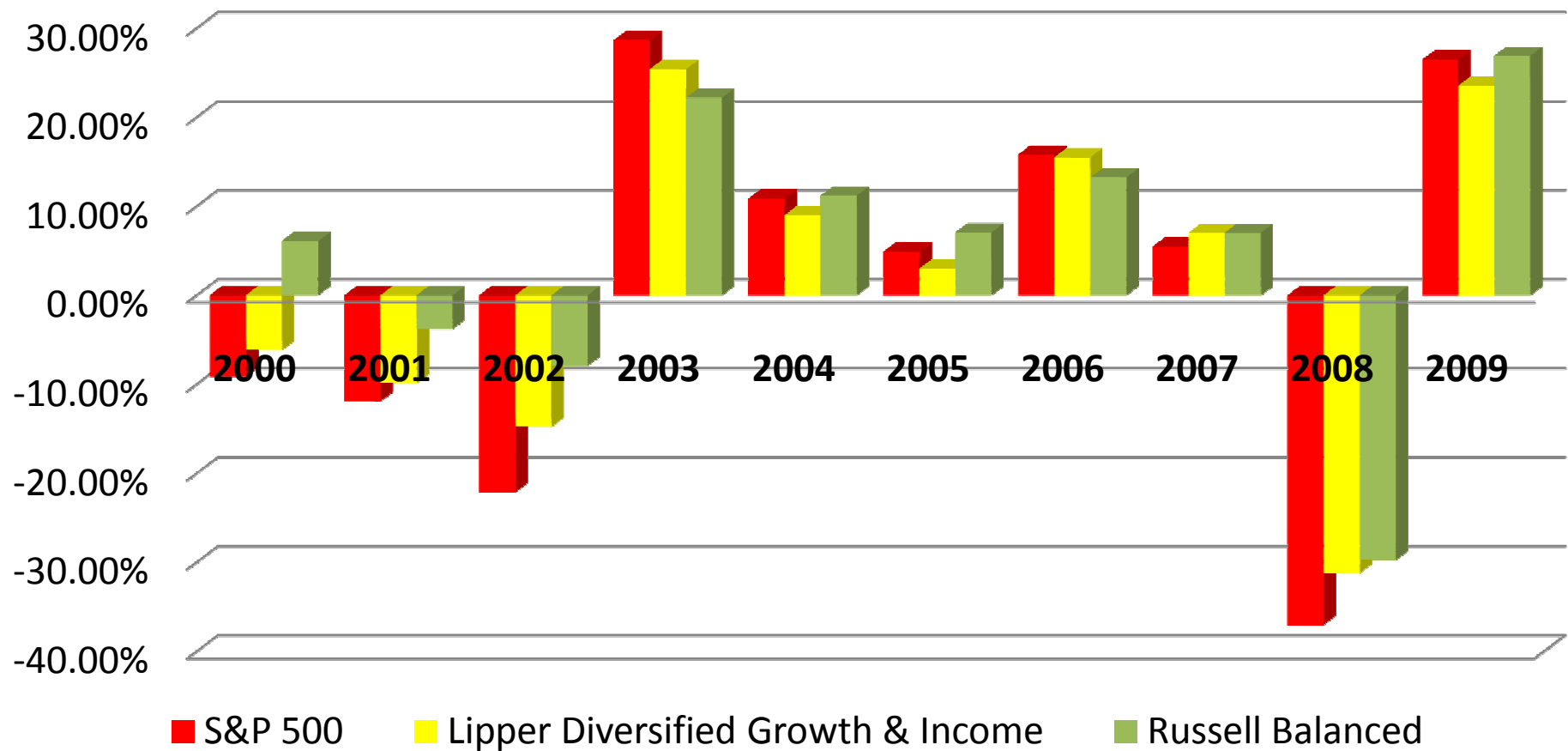
After October 2007, equities marched in relative unison.  
Bonds offered the only significant diversification.

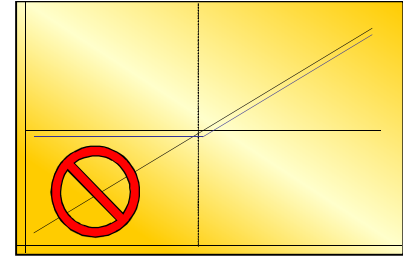




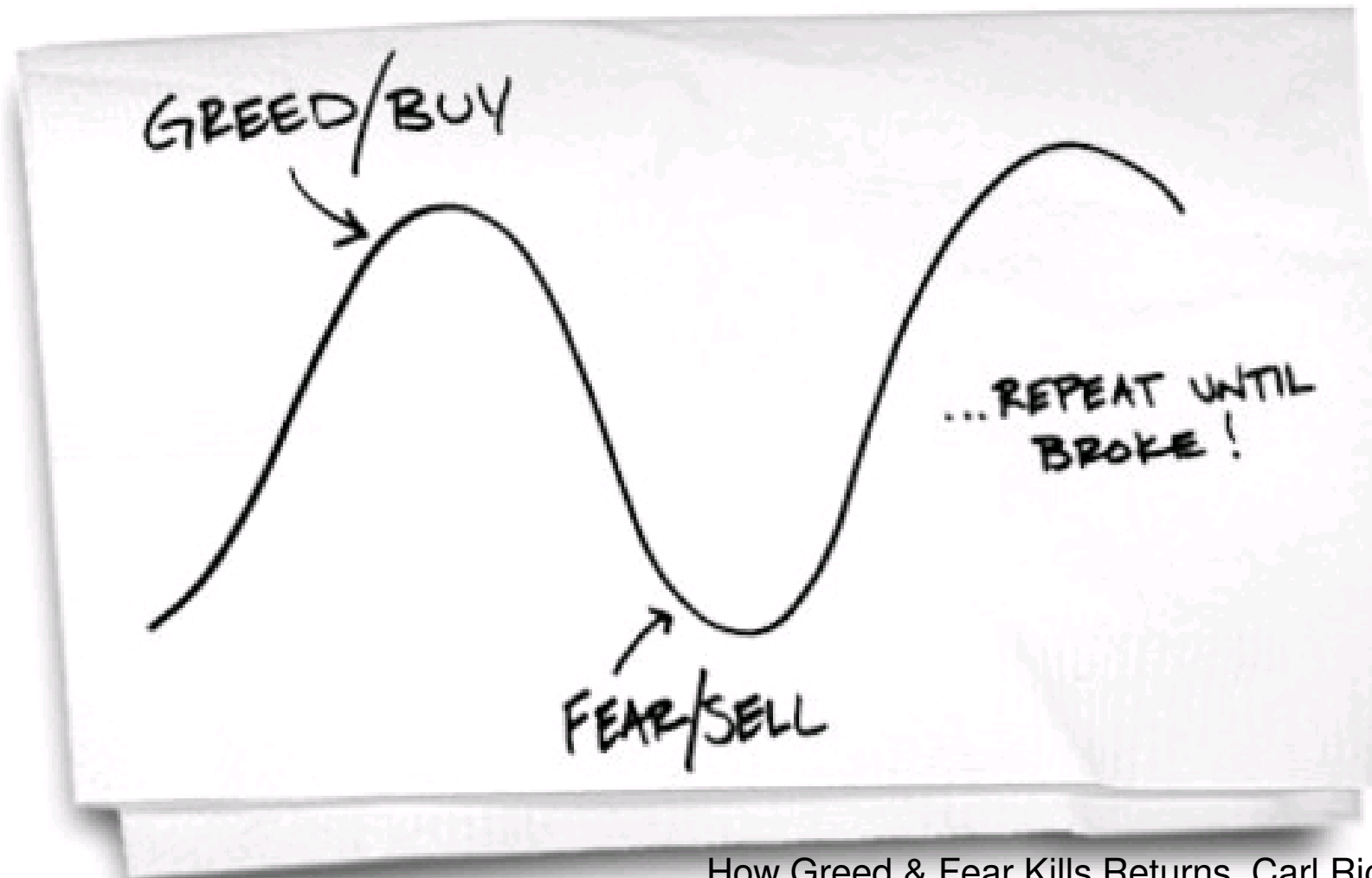
## *S&P 500 vs. Buy and Hope*

**S&P 500 vs. Diversified (60/40)**



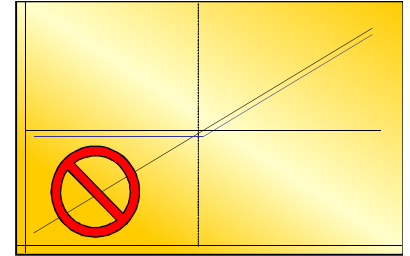


## *Timing the Market - Individuals*



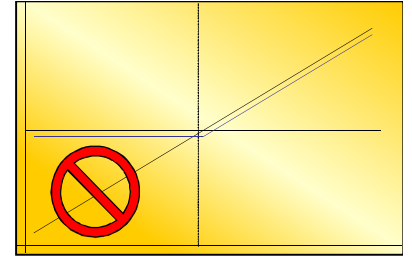
How Greed & Fear Kills Returns, Carl Richards  
New York Times, March 24, 2010





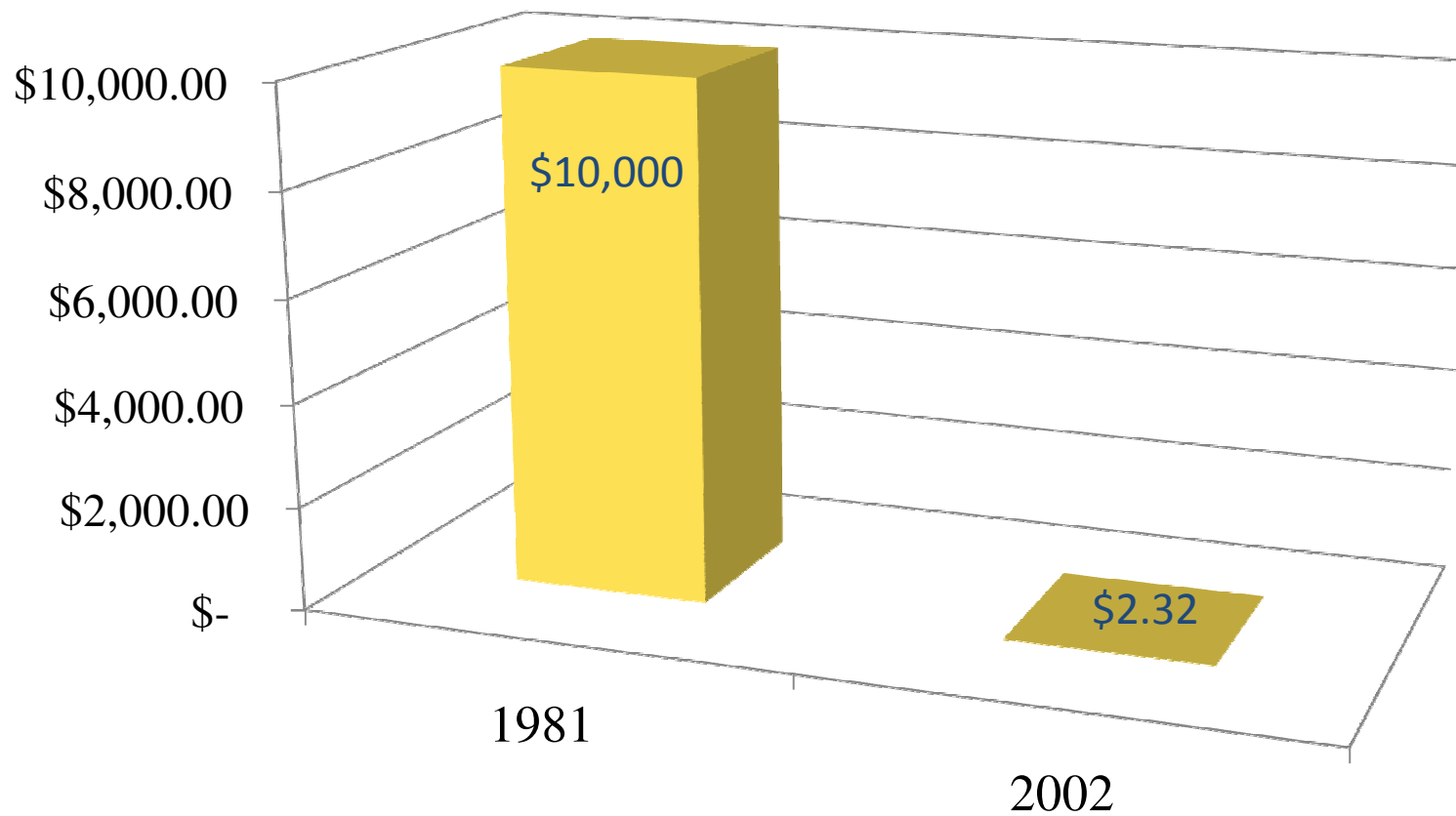
Quantitative Analysis of Investor Behavior  
1984 – 2003

Category	Annualized Return
S & P 500 Index	12.98%
Average Equity Fund Investor	3.51%
Systematic Equity Fund Investor	6.80%
Market Timer Equity Fund Investor	<b>(-3.29%)</b>
Long Term Government Bond Index	11.16%
Average Fixed Income Fund Investor	3.75%
Systematic Fixed Income Fund Investor	5.60%
Market Timer Fixed Income Fund Investor	<b>(-1.85%)</b>
Inflation	3.06%

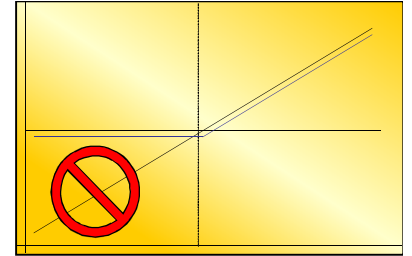


## *Timing the Market - Professionals*

### **Following the Previous Years' Best Market Timer**



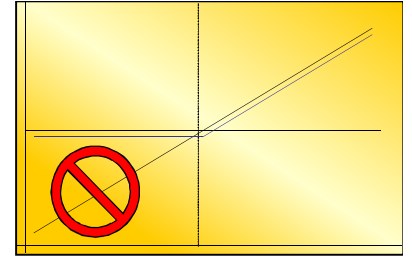
Hulbert Financial Digest, 2004



A study of one hundred large pension funds and their experience with market timing found that while they all had engaged in at least some market timing, **not one had improved its rate of return** as a result. In fact, 89 of the 100 lost as a result of their efforts, and their losses averaged an incredible 4.5% over the five-year period.[i]

1. The Portable MBA in Investing, Edited by Peter Bernstein

[i] 100 large pension plans



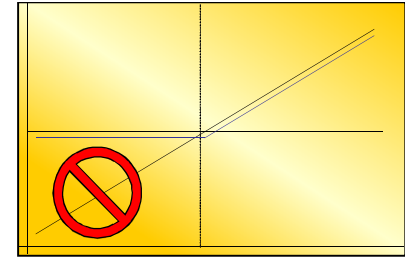
# Bloomberg

## **Morgan Stanley Says Government Defaults Inevitable** *By Matthew Brown - Aug 25, 2010*

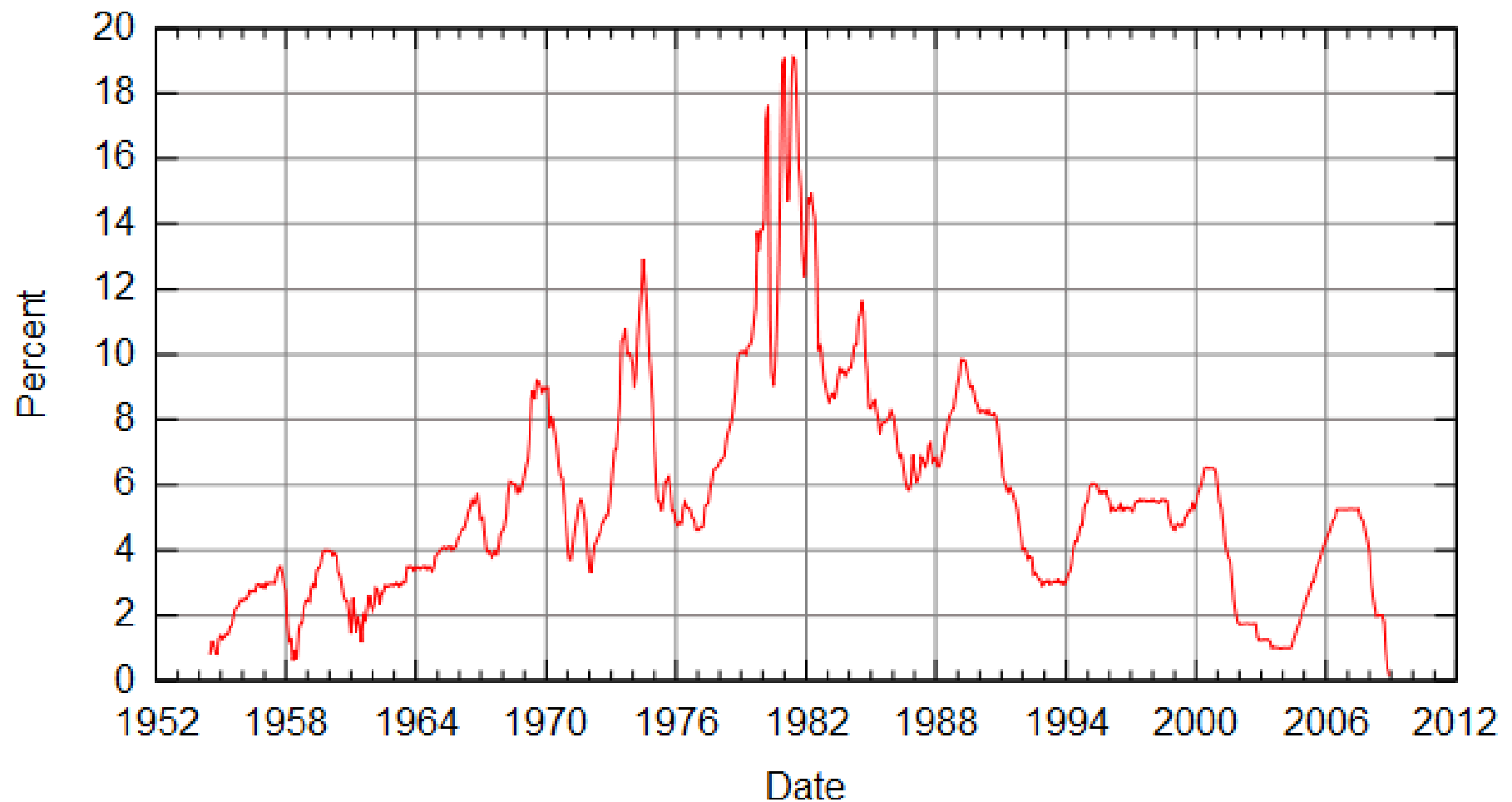
<http://www.bloomberg.com/news/2010-08-25/morgan-stanley-says-government-bond-default-is-question-of-how-not-if-.html>

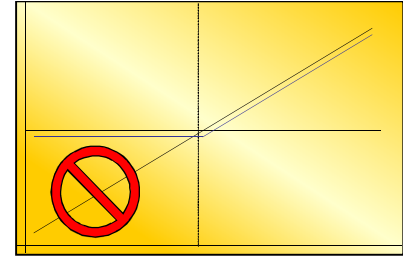
# *Bonds?*

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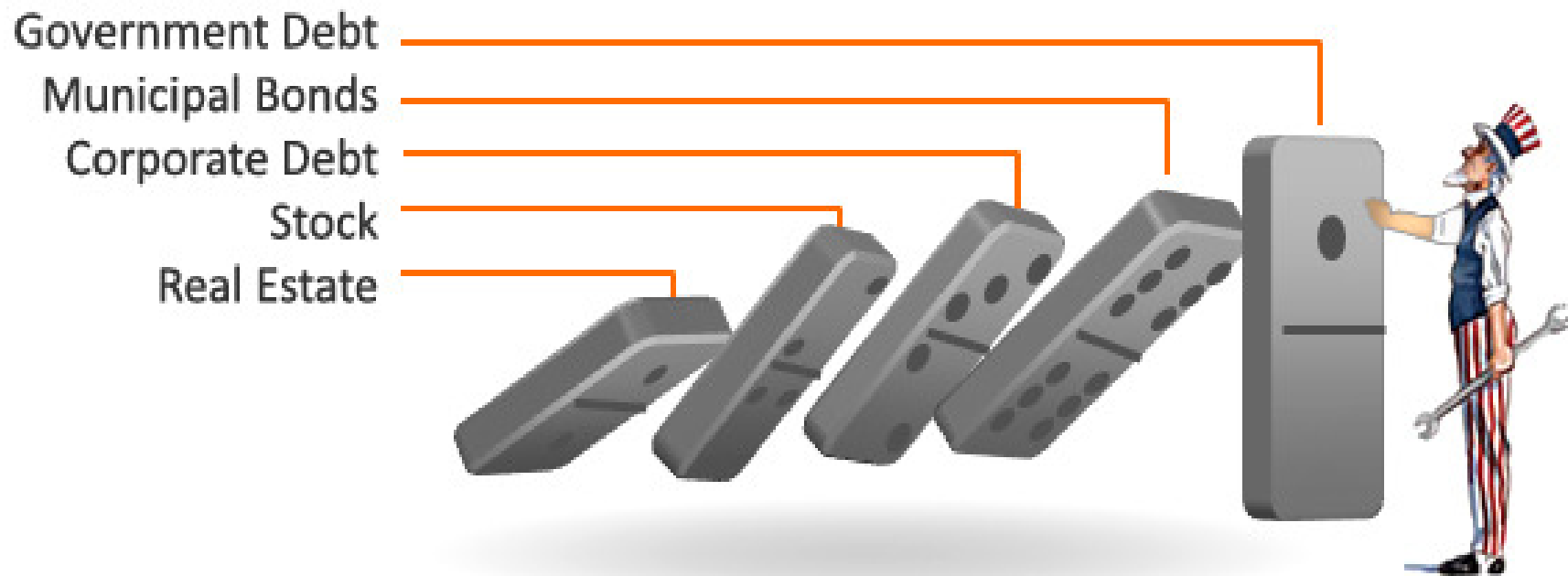


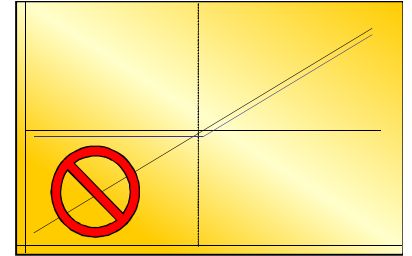
Federal Funds Rate (effective)  
July 1954 to December 2008





*Uncle Sam propping up the markets?*





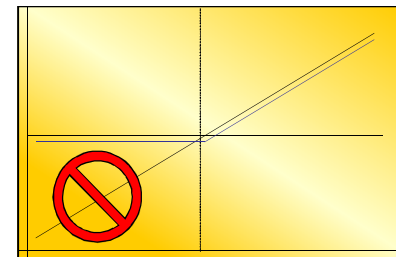
*“In 2008 the QQQ experienced a drawdown of about 50% from peak to trough. Many other asset classes which are generally considered effective equity diversifiers also faced significant losses.*

*This type of contagion across asset classes suggests that in times of major systematic stress, direct hedges through protective option strategies may provide equity portfolios with greater downside risk protection than standard multi-asset diversification programs. “*

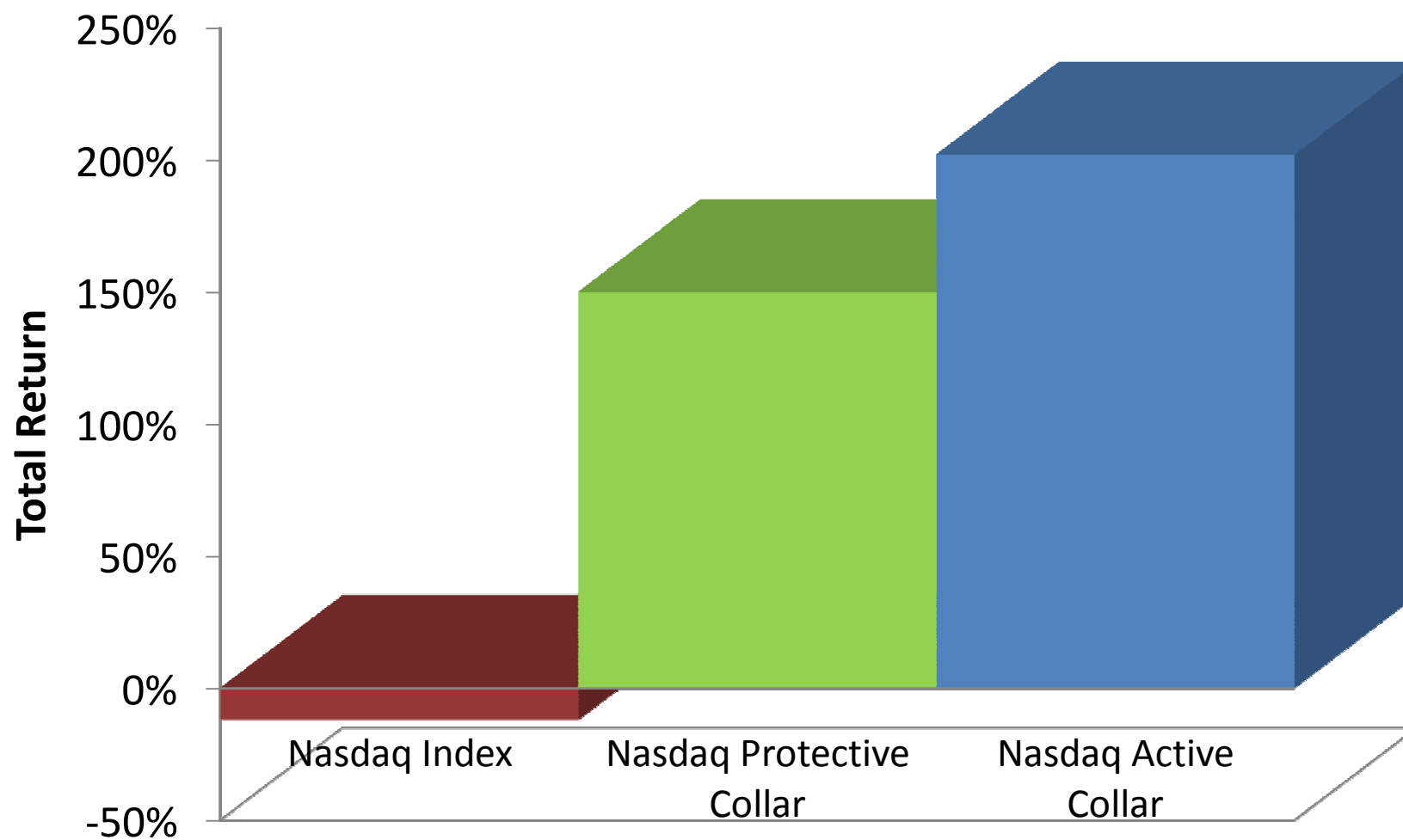
From “Loosening Your Collar: Alternative Implementations of QQQ Collars”

# *Collaring the Cube*

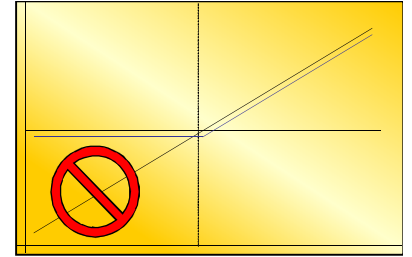
Swan Consulting, Inc



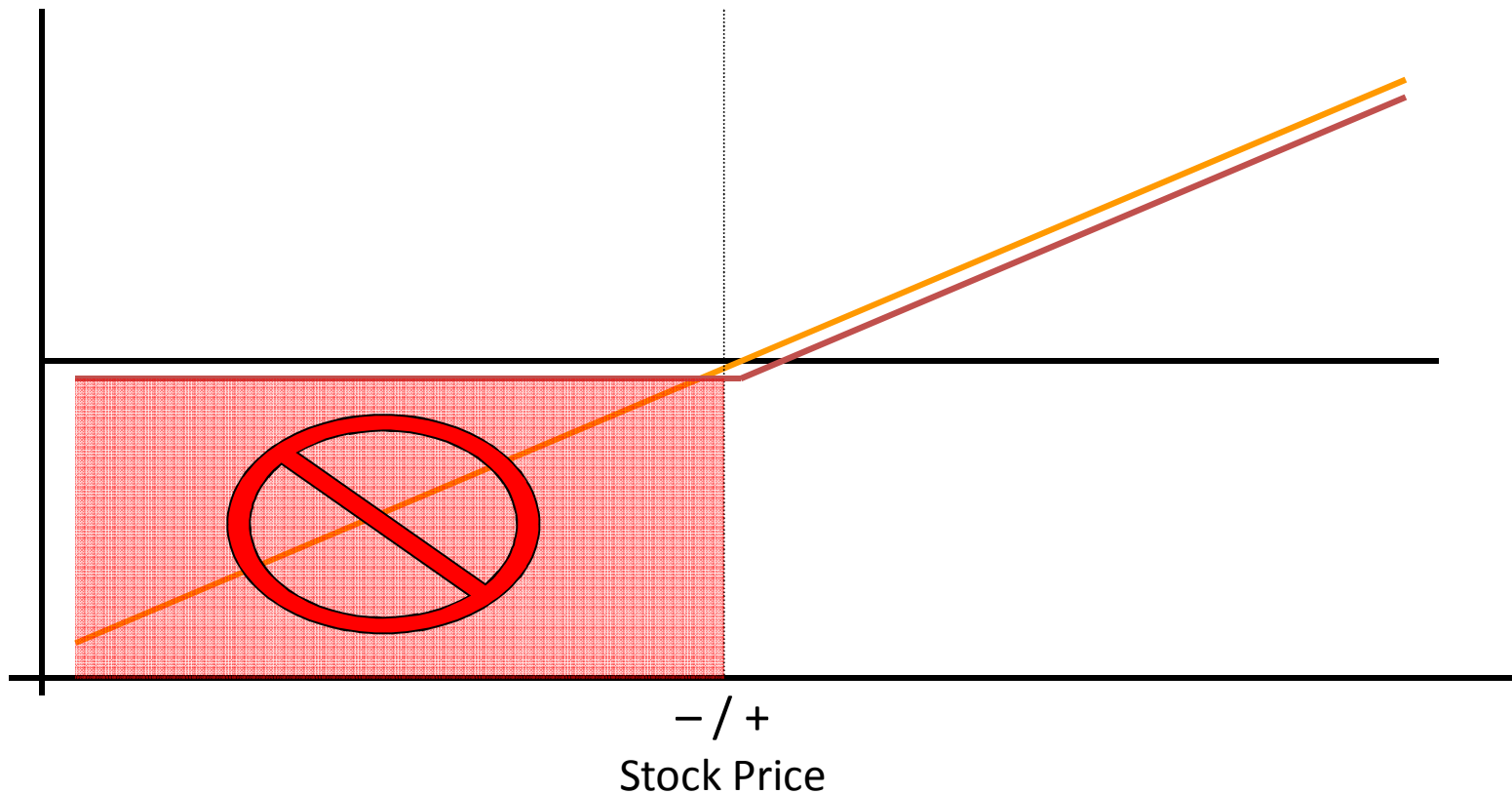
**1999 to 2009**





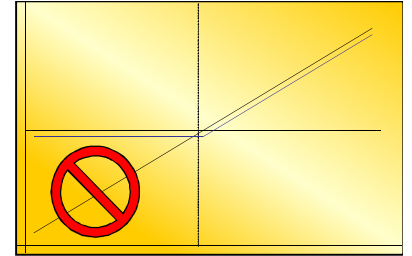


- Get rid of the risk you don't want.



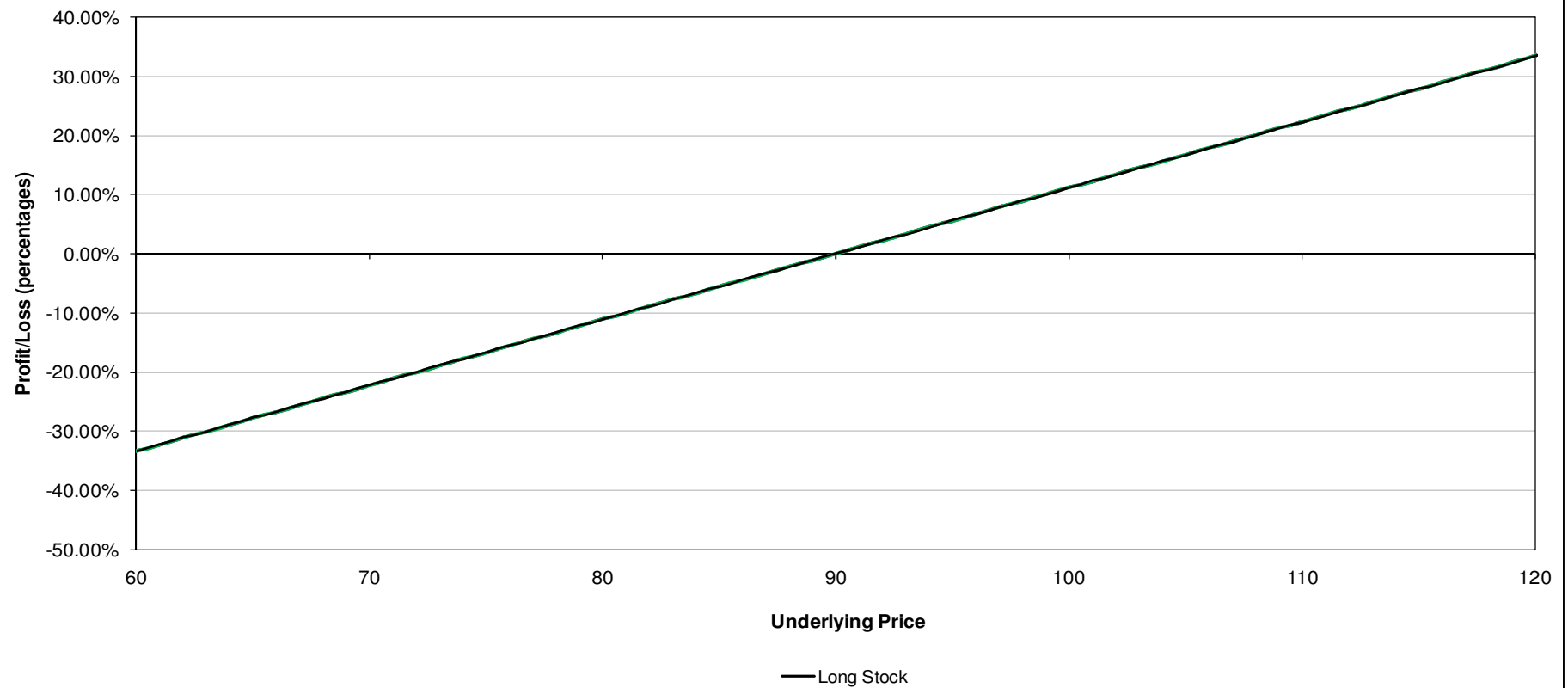
“Prophesy as much as you like, but always  
hedge.”

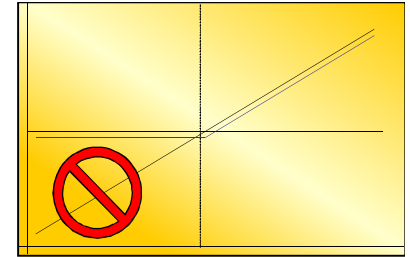
Oliver Wendell Holmes - 1861



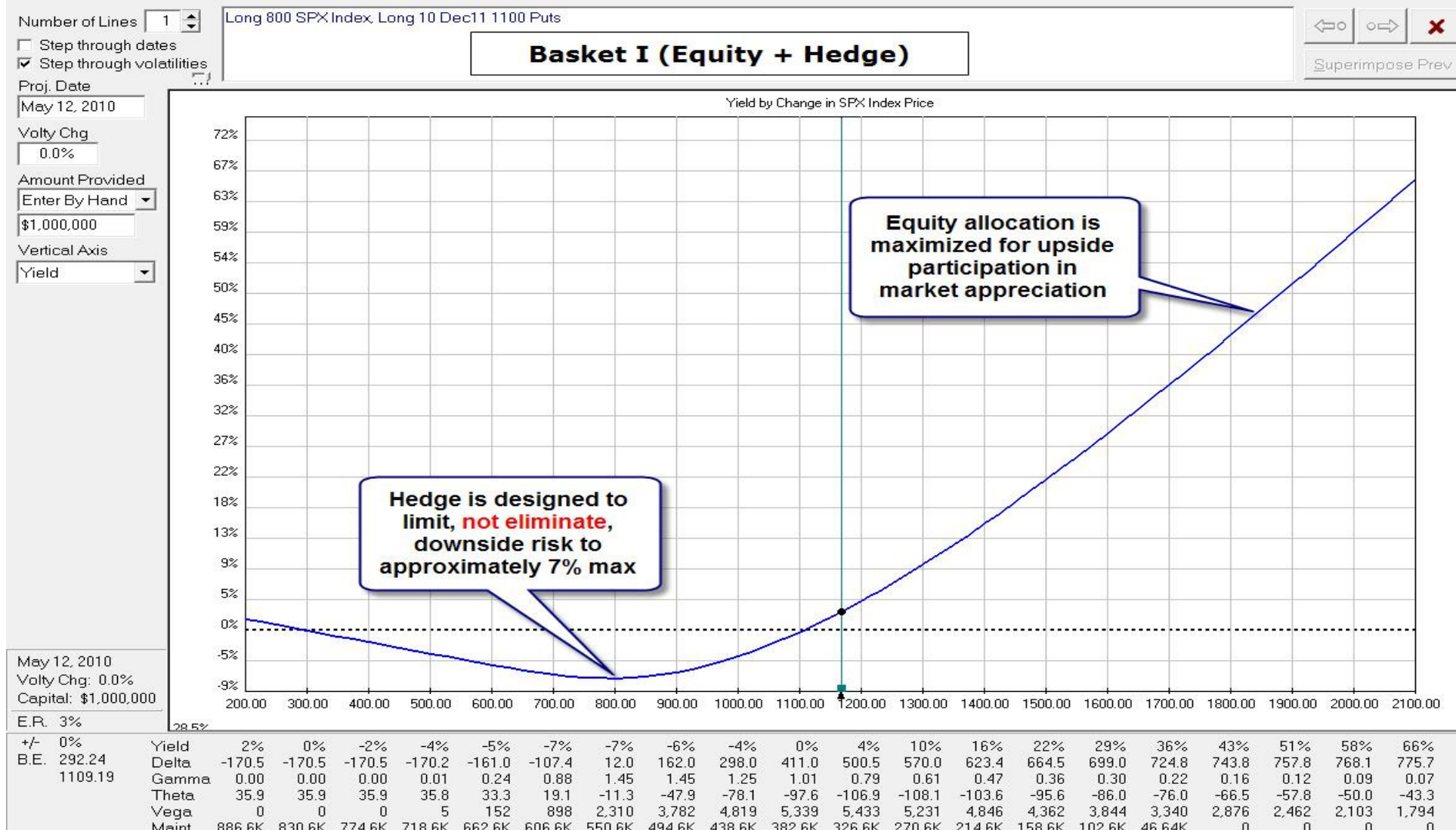
## Long Stock potential outcome graph

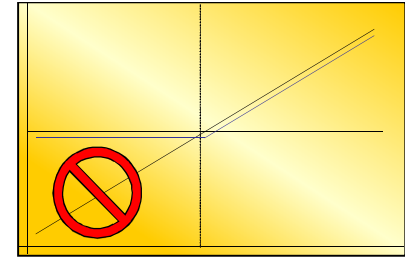
Long Stock



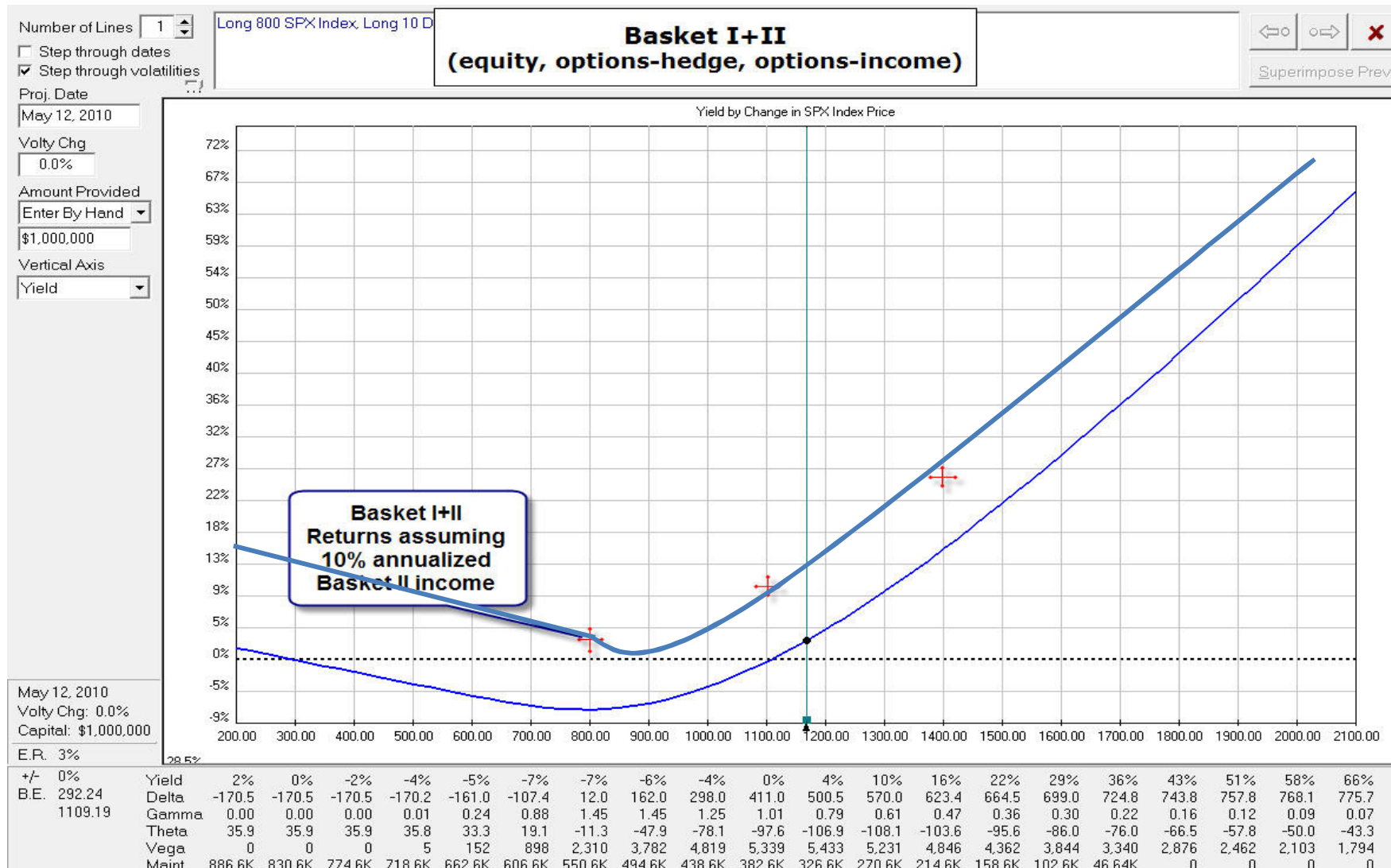


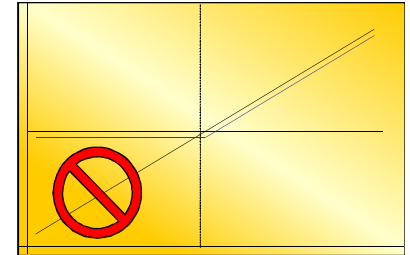
## Managing the Hedge creates upside potential when market crashes



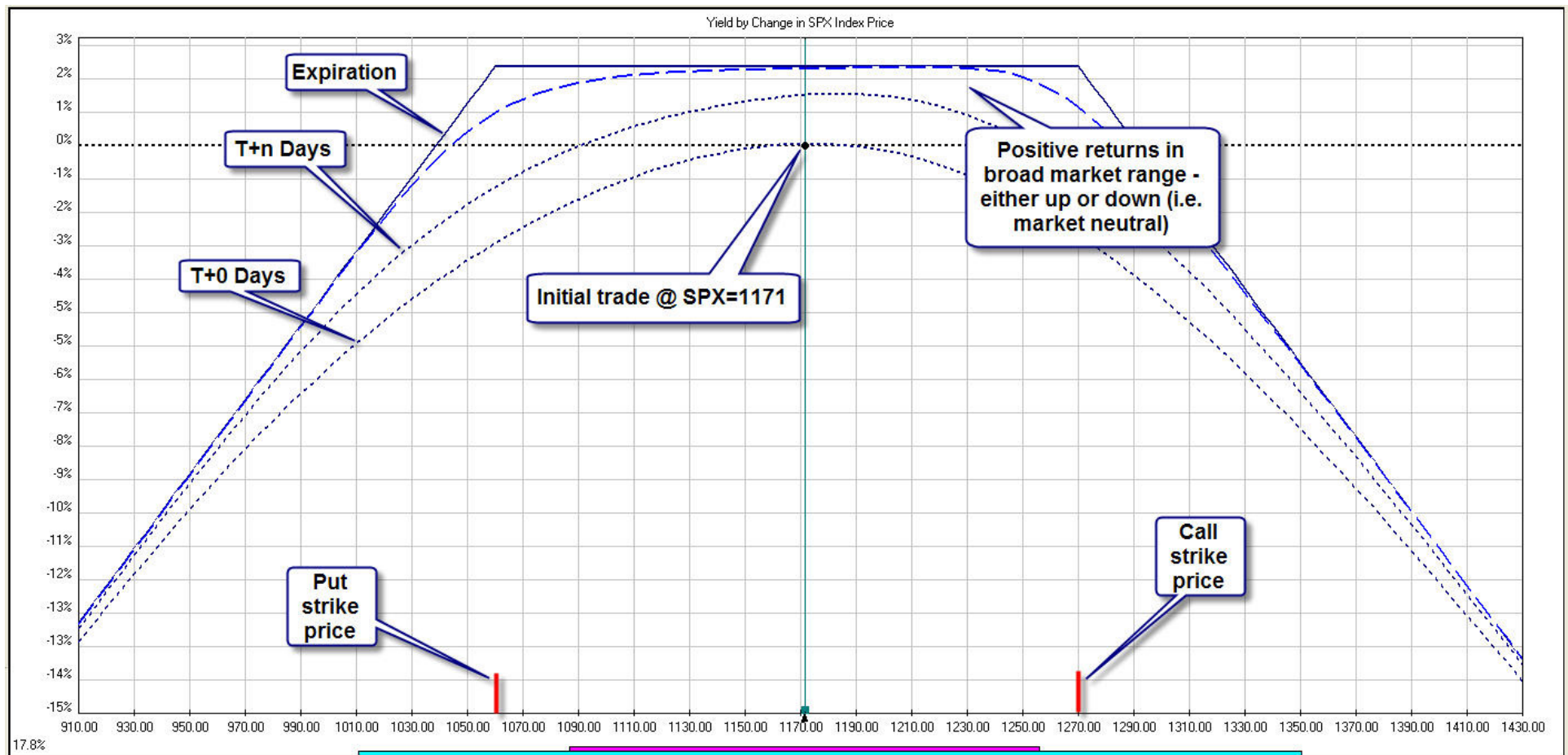


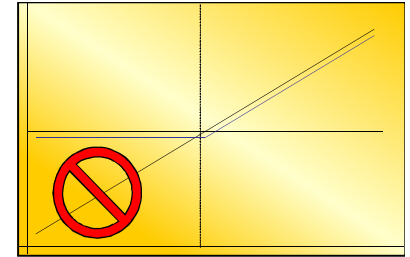
## Shifting the outcome upward through option income strategy





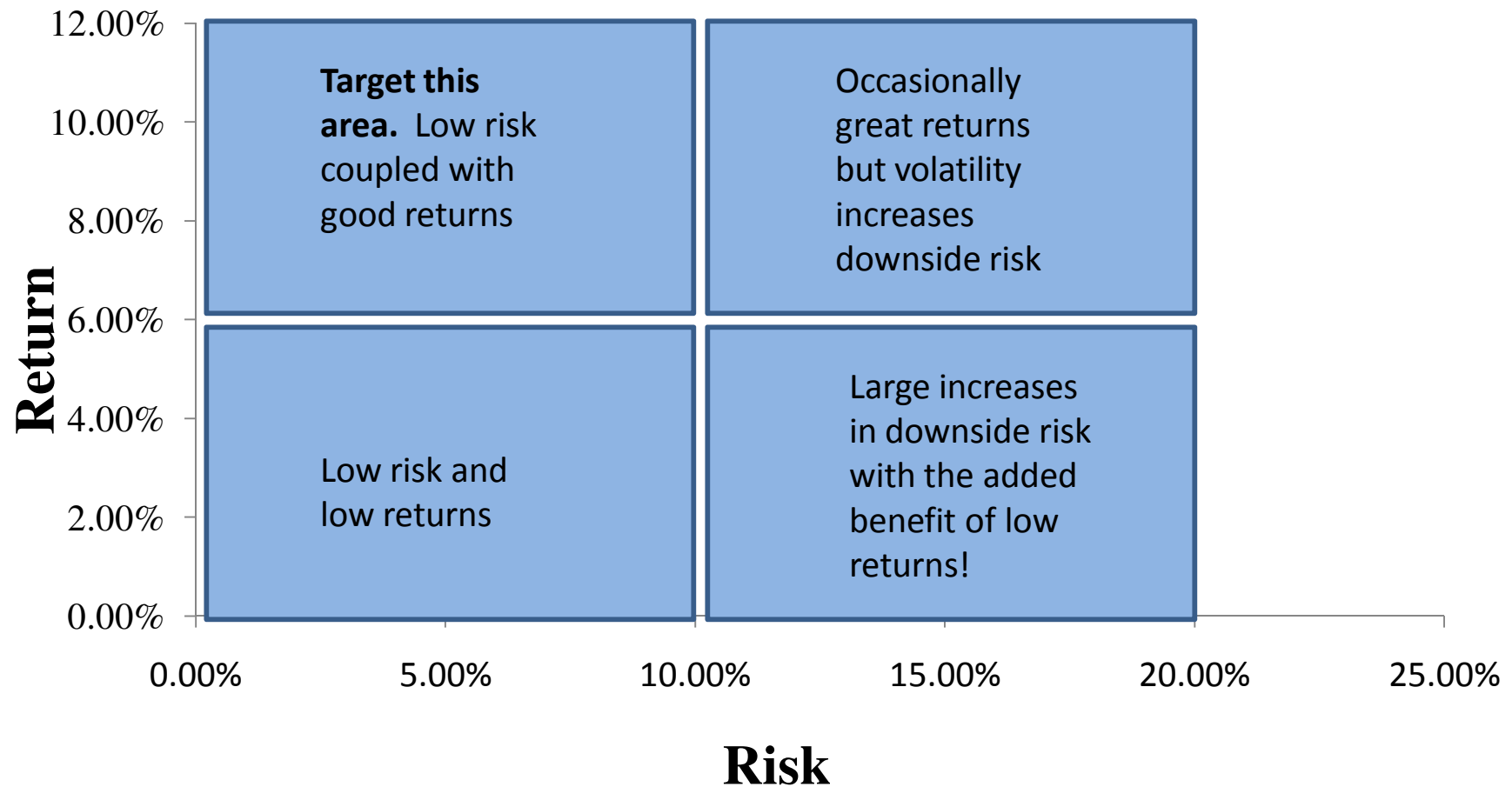
## Option Income Trade Example

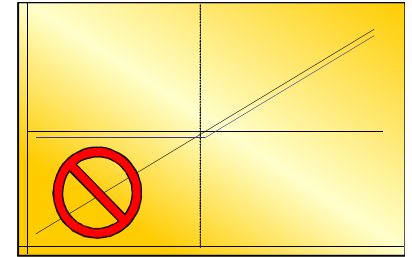




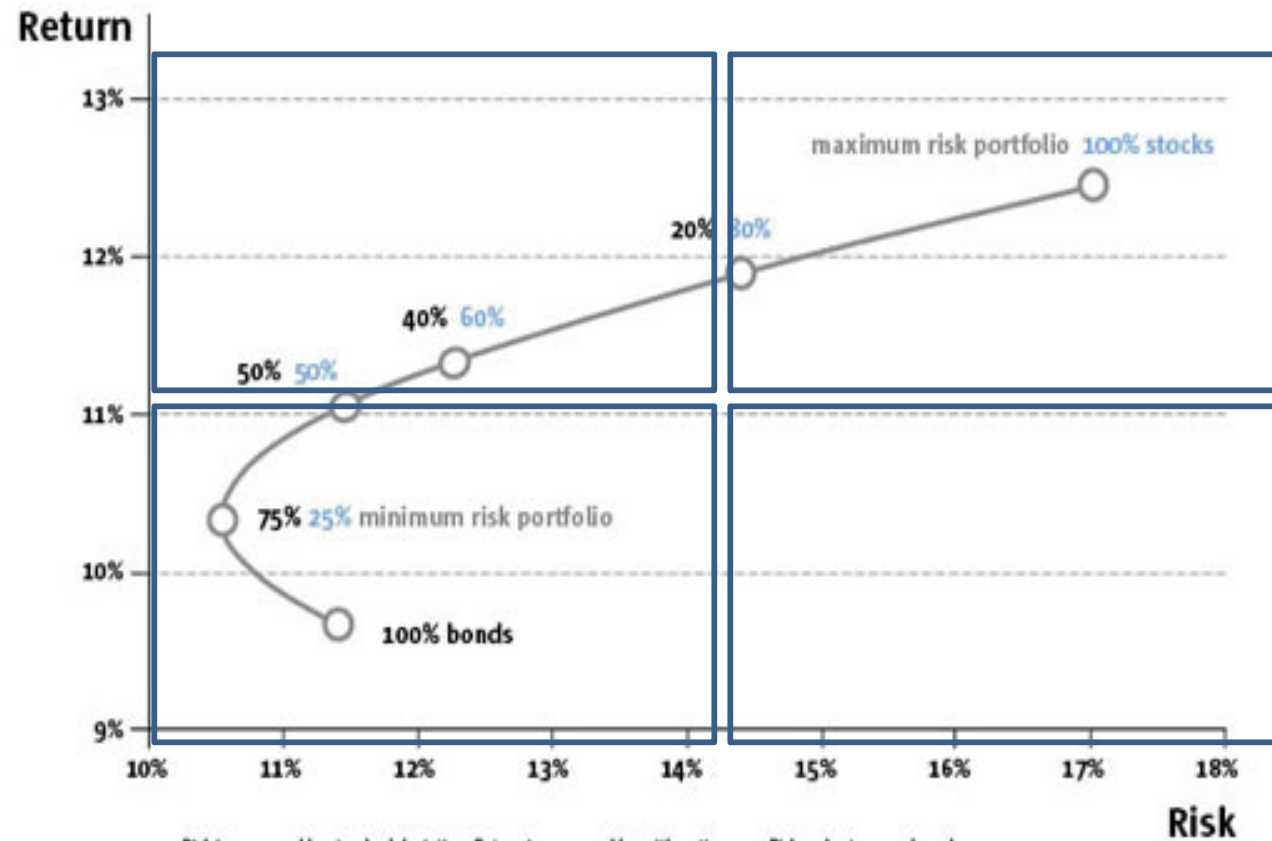
## Conclusions

### Risk / Return



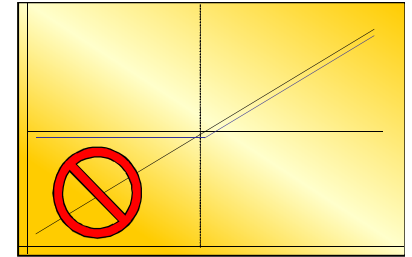


## Stocks and bonds: risk versus return 1970-2005

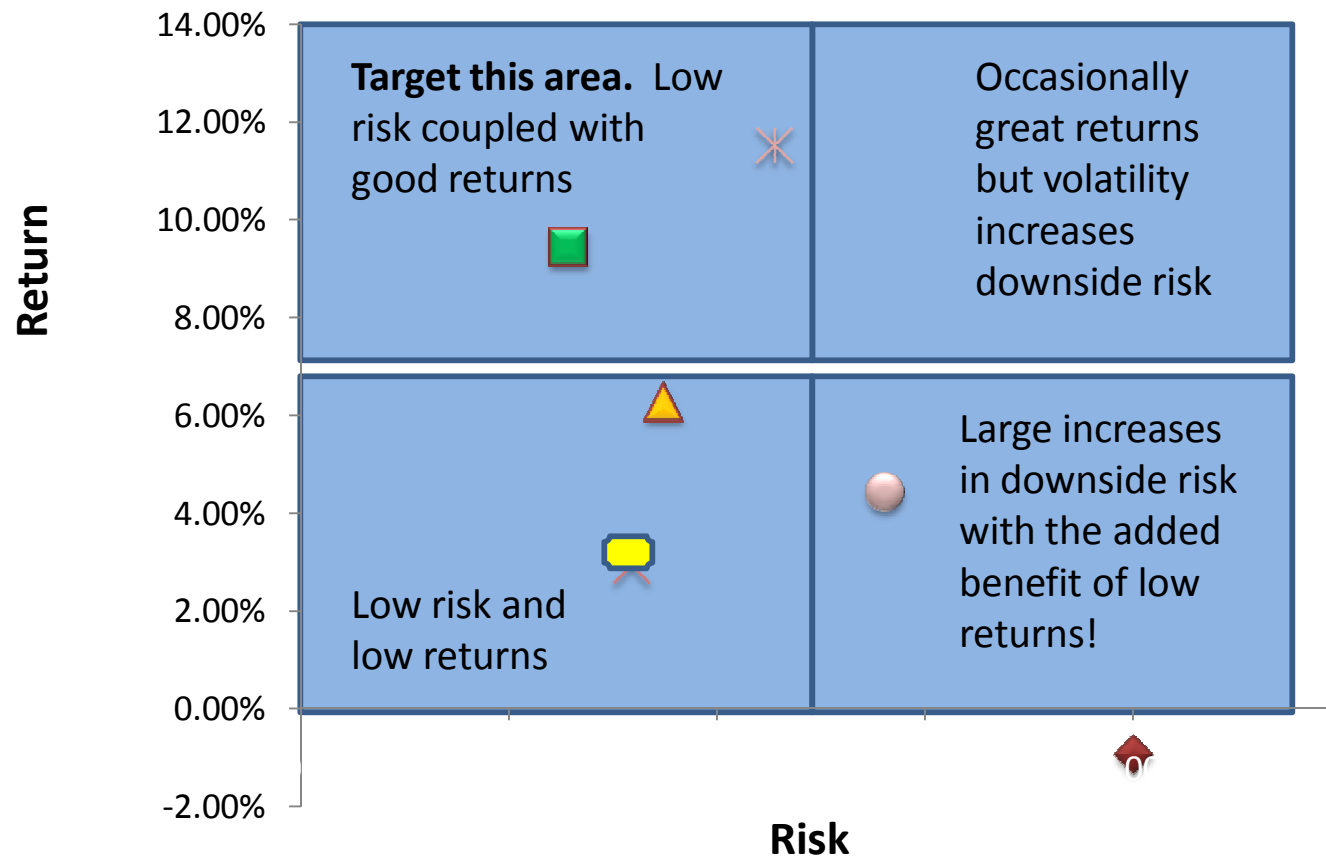


Risk is measured by standard deviation. Return is measured by arithmetic mean. Risk and return are based on annual data over the period 1970-2005. Portfolios presented are based on modern portfolio theory.

This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. 1/1/2008

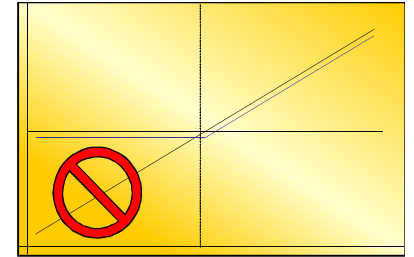


## Risk : Return

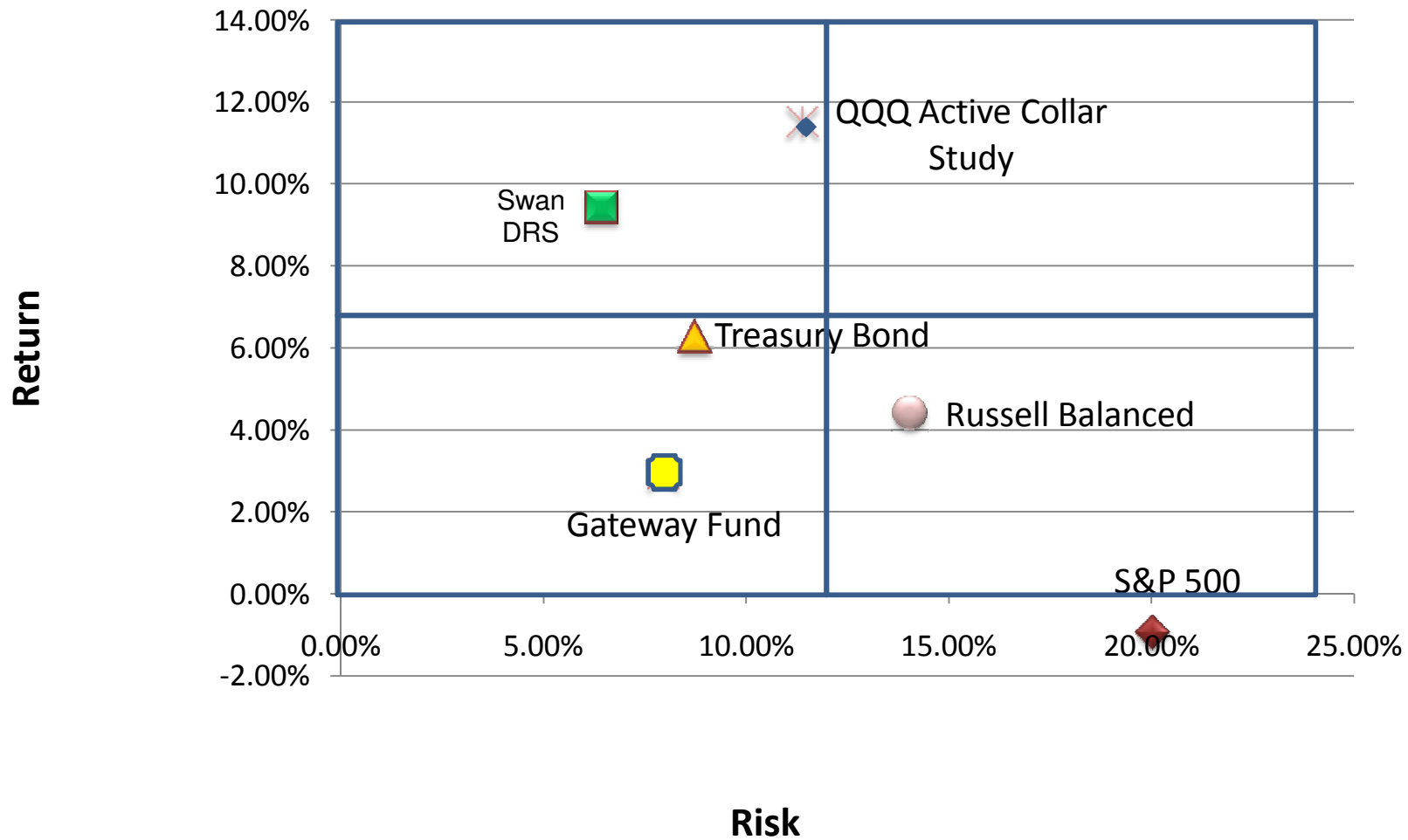


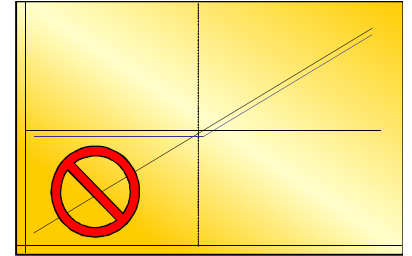


# Lost Decade

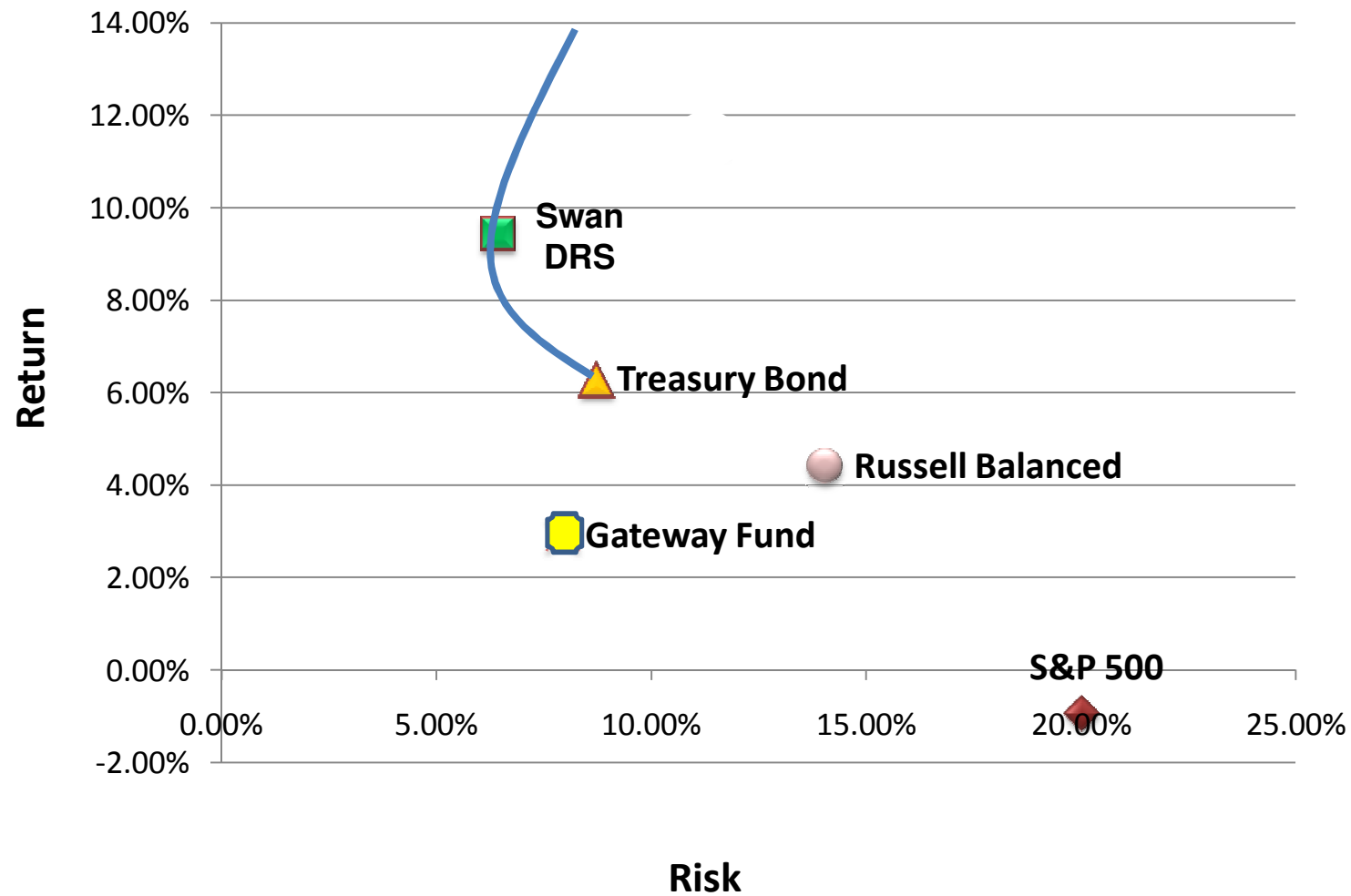


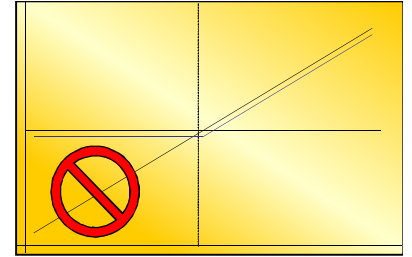
## Risk Return: The Lost Decade





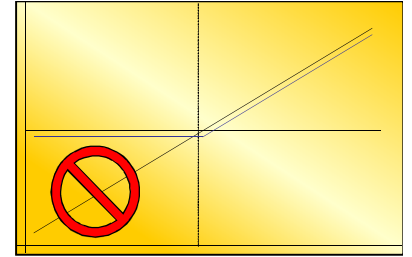
## The New Efficient Frontier?





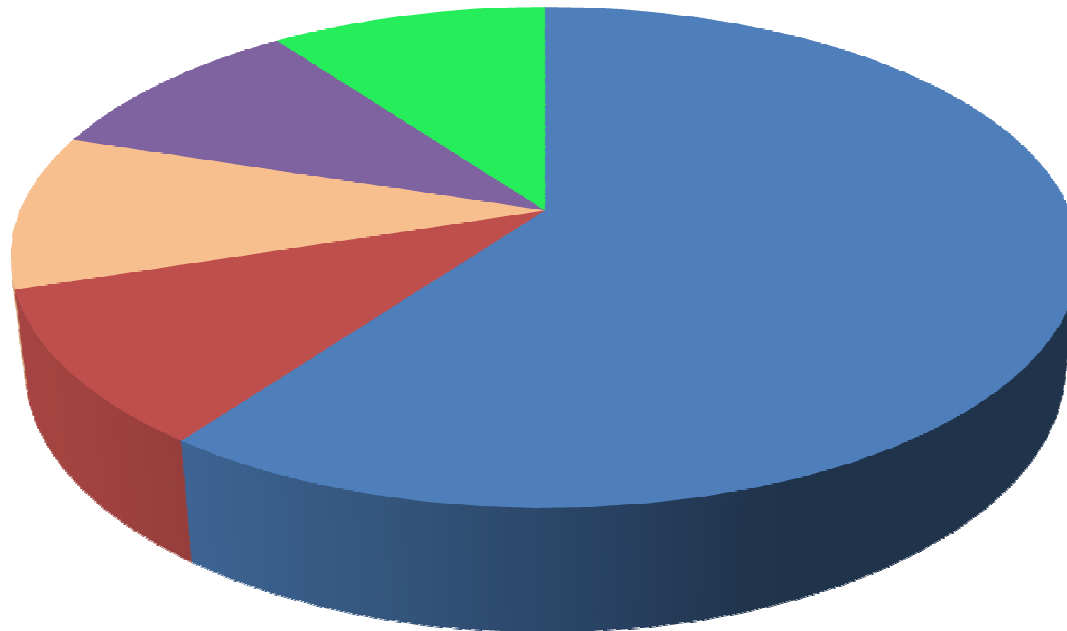
## Swan Defined Risk Strategy

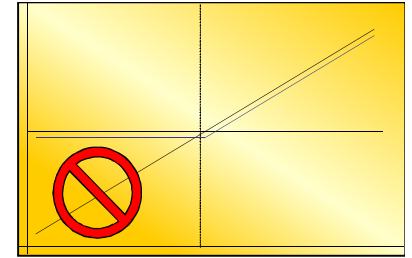
- Long with hedge
  - Hedge is not buy and hold but managed and re-hedged at least annually.
- Income Strategy
  - Market neutral - taking both sides using options.
  - Managing the trades via specific rules
  - Probability analysis - 88% of income trades are profitable.



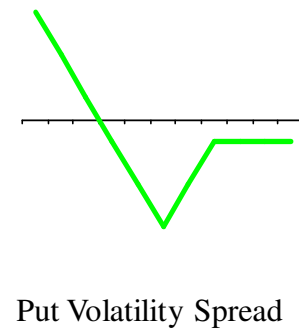
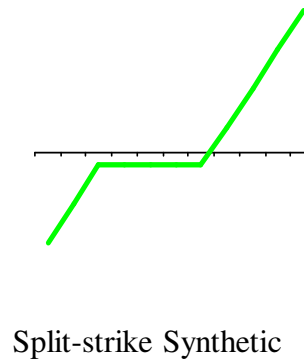
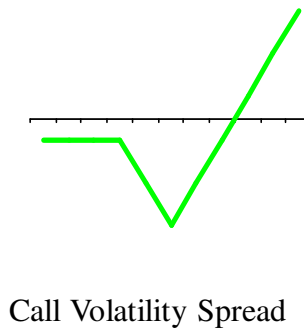
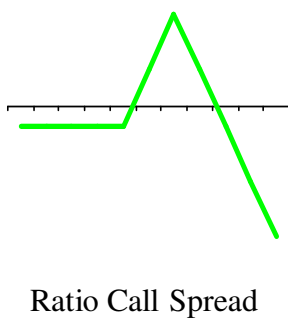
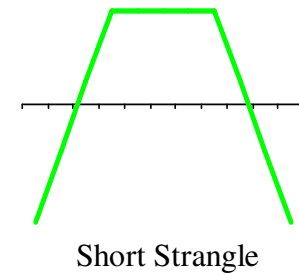
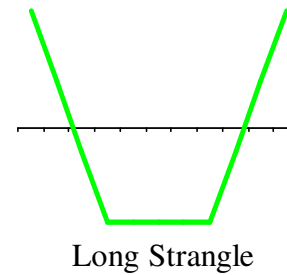
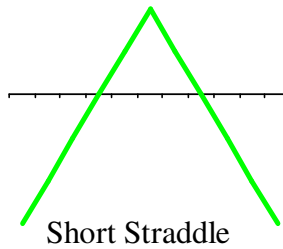
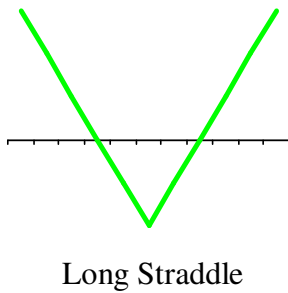
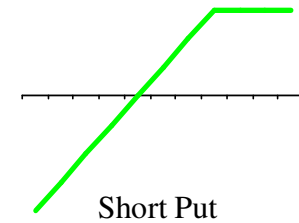
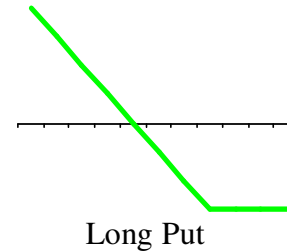
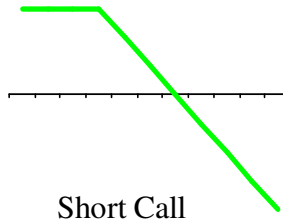
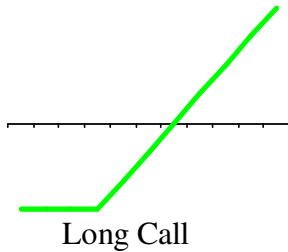
## Options: The New Asset Class?

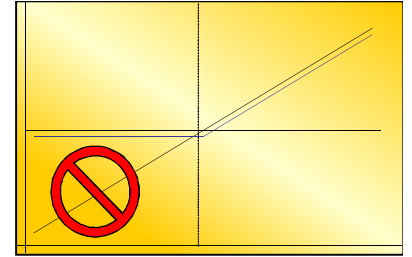
■ Stocks ■ Bonds ■ Commodities ■ Real Estate ■ Options





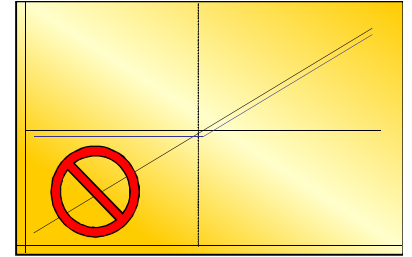
## Options Give You Options!





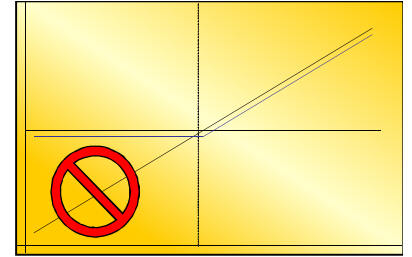
## Options – The Concept

- Options are similar to insurance policies.
- Buyer gets payout if conditions are met
- Price varies depending risk of asset
- Price varies by amount of deductible
- Limited time period (expiration date)
- Many policies/options to choose from



## Whose Using Options?

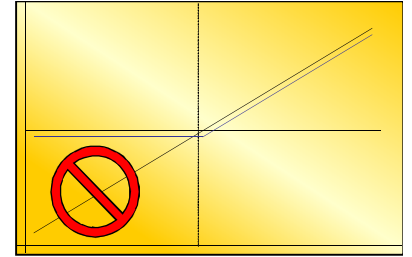
- Farmers
- Fortune 500 Companies
- Insurance Companies
- Oil Companies
- World's Wealthiest
- Hedge Funds/Sophisticated Money Managers



## Possible Objectives

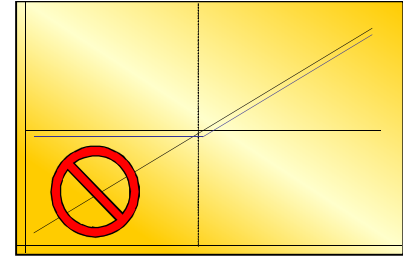
- Generate income
- Protect a stock or portfolio
- Lower the cost of protection
- Target a stock purchase price below today's stock price





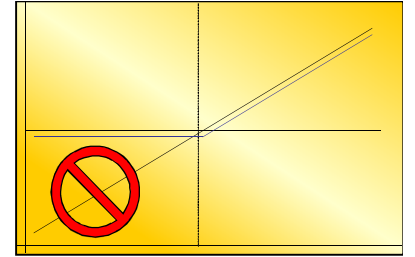
## Income Strategies

- Investors can sell options to increase income
- Pay for protection
- Must know alternatives if market moves against you



- **Best Managers**

- Manage the risk of being wrong regarding market direction
- Manage with eye on what is happening vs. what they hope will happen
- Deliver positive alpha due to systematic approach to minimizing risk
- Deliver positive alpha due to systematic approach to maximizing return



“Prophecy as much  
as you like, but  
always hedge.”

Oliver Wendell Holmes - 1861