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How to safeguard your equities portfolio and protect your wealth without diversification.

Marcel Collignon

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This information is current as at 7 July 2014

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Then Vs Now

1950's

Now

Then Vs Now

1950's

Now

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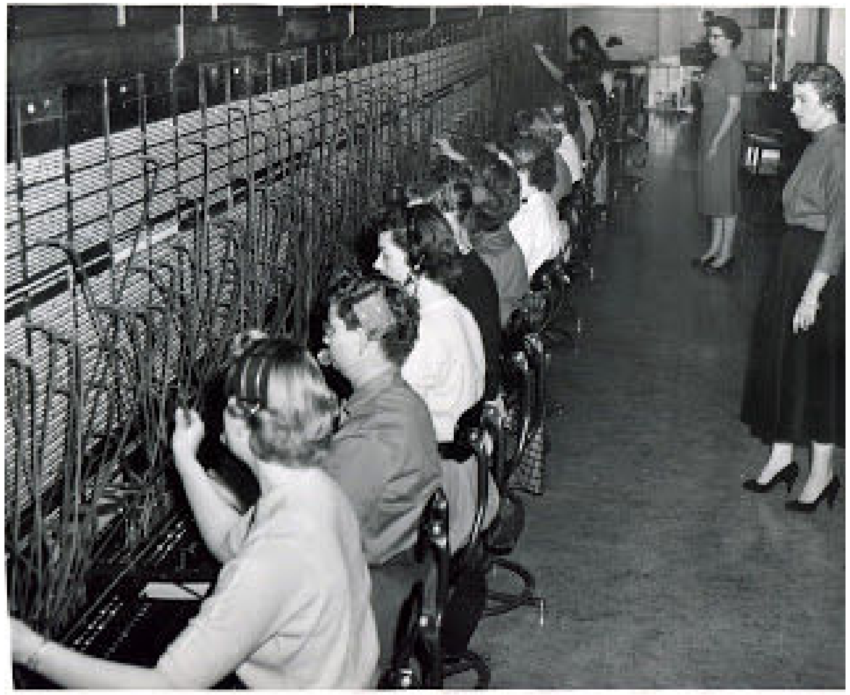
Then Vs Now

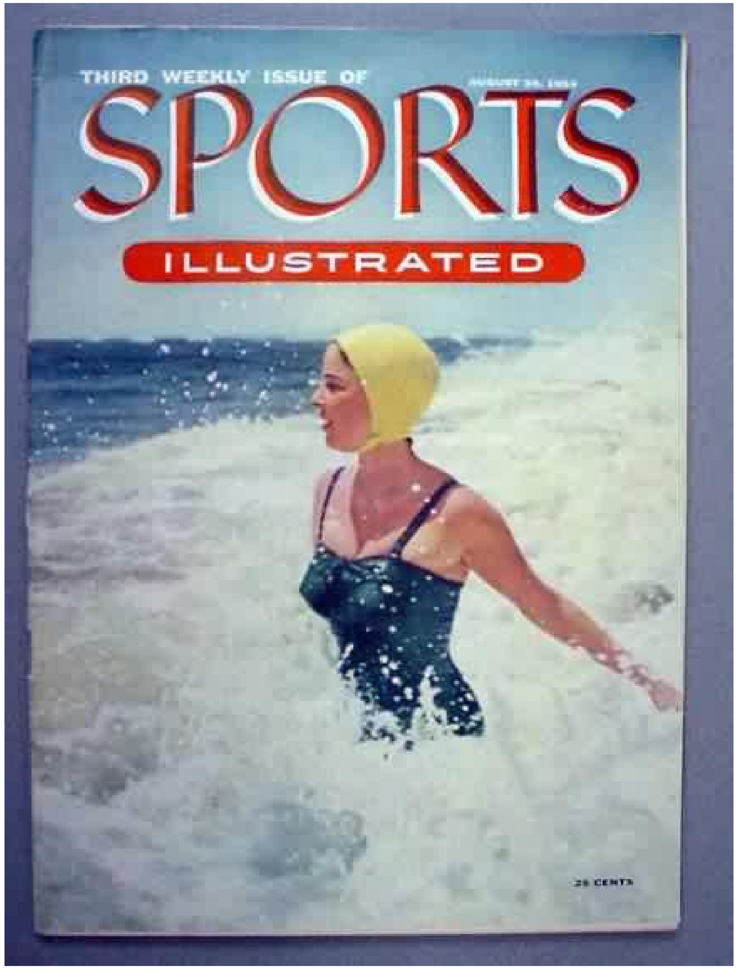
1950's



Now

Then Vs Now

1950's



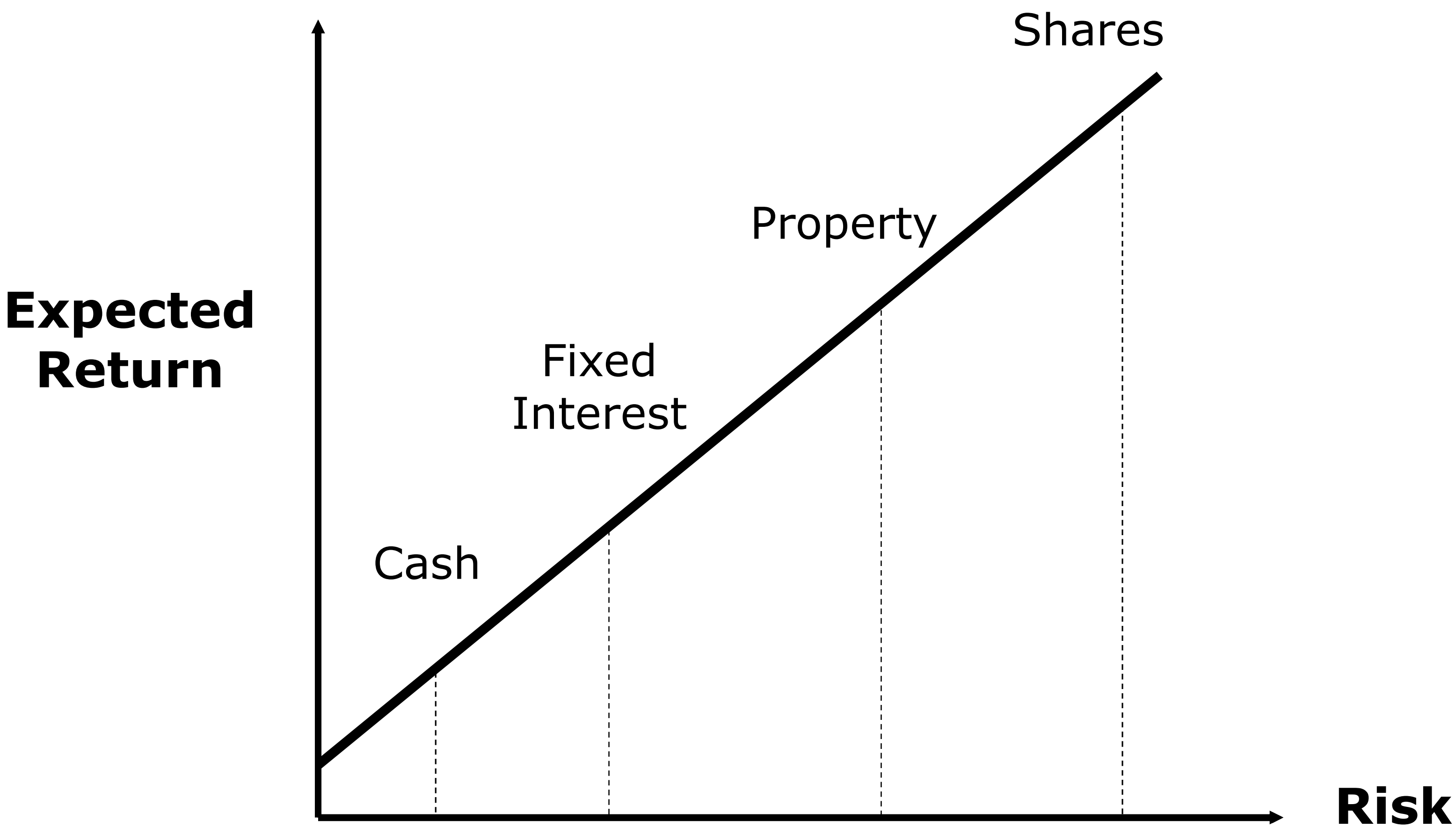
Now

Then Vs Now

1950's – Harry Markowitz – Portfolio Theory

Now – Harry Markowitz – Portfolio Theory

Accepted Risk Return Trade Off



Share Market Risk

- The short term volatility of the share market creates a high level of risk.
- RISK – The possibility of loss
- Share market risk factors include:
  - International risk
  - Overall market risk
  - Stock specific risk

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Accepted method for managing these risks

Diversification:

- Spreading the total investment over a variety of shares and/or asset classes in the pursuit to reduce risk
- While diversification spreads risk it also reduces the potential return
- Assumes that Asset Classes are "Uncorrelated"

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The Warren Buffet Way

- Choose a few stocks that are likely to produce above average returns over the long term.
- Concentrate the bulk of your investment in those stocks.
- Have the fortitude to hold steady during any adverse short term movements.

(The Essential Buffett, timeless principles for the new economy, R Hagstrom)

Reduce concentration risk

- Risk can be reduced by buying insurance.

Insurance on Shares?

- A **Put Option** gives the buyer the right but not the obligation to sell the underlying shares at a predetermined price on or before a future date.

Insurance - Protection for your assets

- **What is insurance?**
- Example: Car Insurance

  - **Key Features**
    - Agreed Value: $40,000
    - Time to Expiry: 12 months
    - Premium: $1,000
    - Excess: $600

Insurance - Protection for your assets

- **<u>What is Put Option?</u>**
  - A Put Option is the right to sell, but not the obligation, at an agreed price, on or before an agreed date.

- **<u>Example: Dec 2013:</u>**

  WBC Bank. Price $31.31 (19 Dec 2013)

  - **<u>Put Options Key Features</u>**
    - Agreed Value (Strike Price): $31.31
    - Time to Expiry: Dec 2014 (~12 months)
    - Premium: $2.51
    - Excess: $0.00

Insurance - Protection for your assets

- **Example Cont'd:**

  WBC Bank. $31.31 (19 Dec 2013)

  - **Worked Example:** Jimmy wants to buy ANZ as he sees upside, but is concerned the share may fall in value. Jimmy has approx $300,000 to invest.

Buy 10,000 ANZ shares at $31.31:	$313,100
Buy 100 ANZ $30.00 Put options @ $2.51:	($25,100)
Expected Dividends & FC's ($1.80 + FC = $2.57):	$25,700

Risk if dividends are not paid:	($25,100)
Risk if dividends are paid:	**$600 gain**

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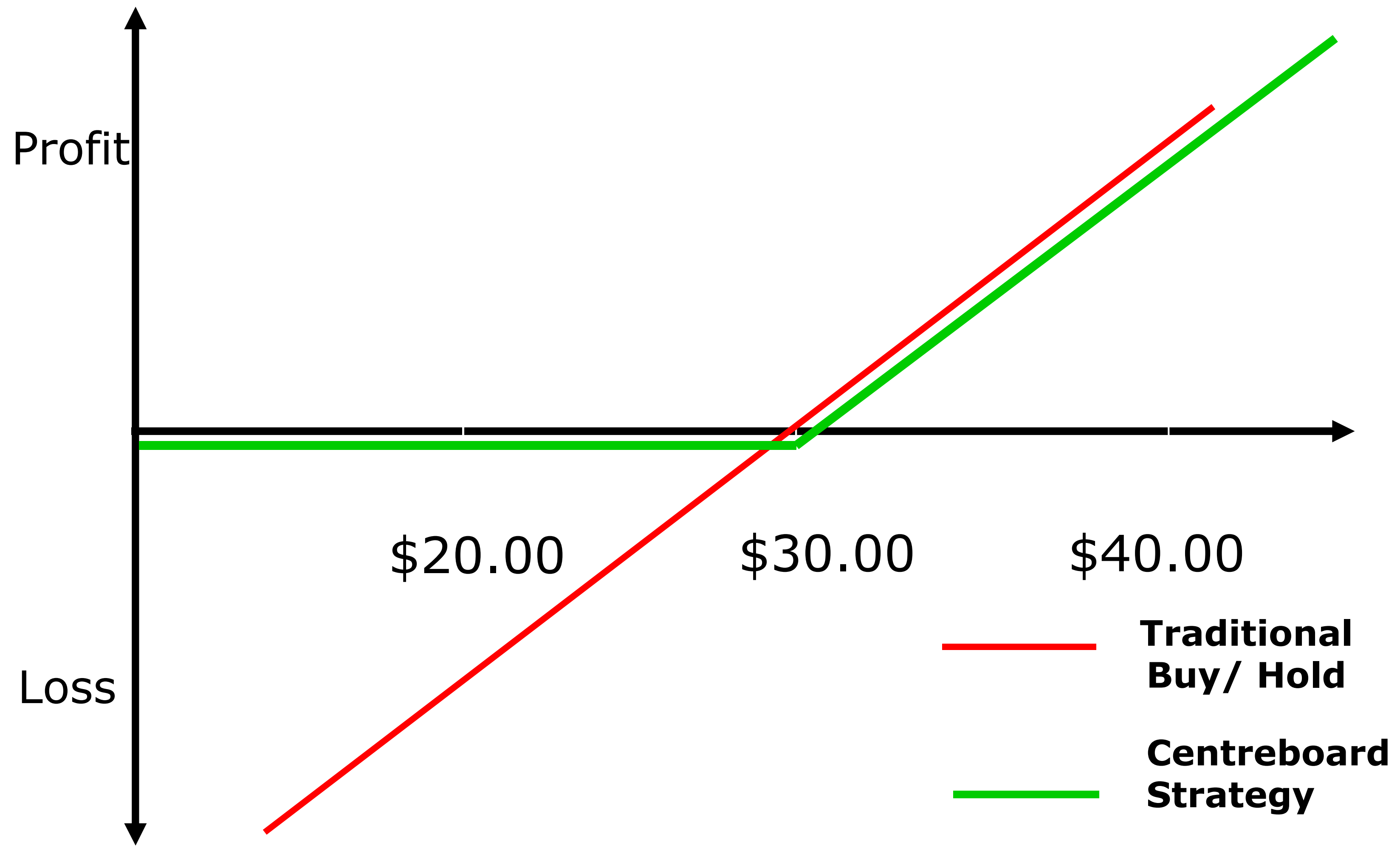
Comparative Payoff Diagram



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Centreboard Approach

- Adopt a focused investment philosophy to have the capacity to make substantial capital gains.
- Concentrate the bulk of your investment in those stocks.
- Reduce the risk by buying insurance.
- Use the dividend income to pay for the cost of the insurance over the course of the year.

Risk of the Centreboard Strategy

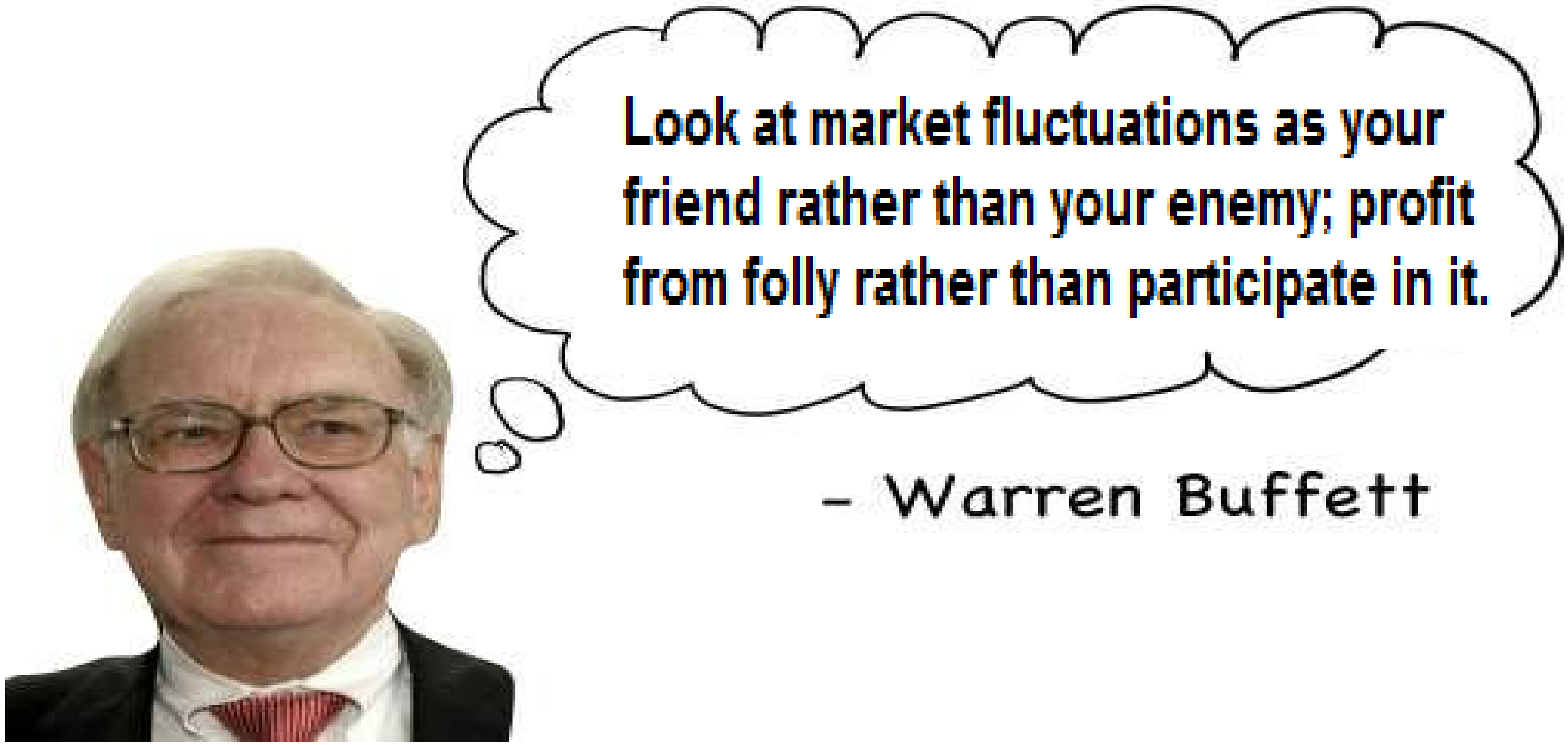
- The company reduces their dividend so the cost of the Put Option is not entirely offset by the dividend.

- The maximum down side risk is therefore the cost of the Put Option.

The Warren Buffett Way

1.Never lose money.

2. Never forget rule number 1.

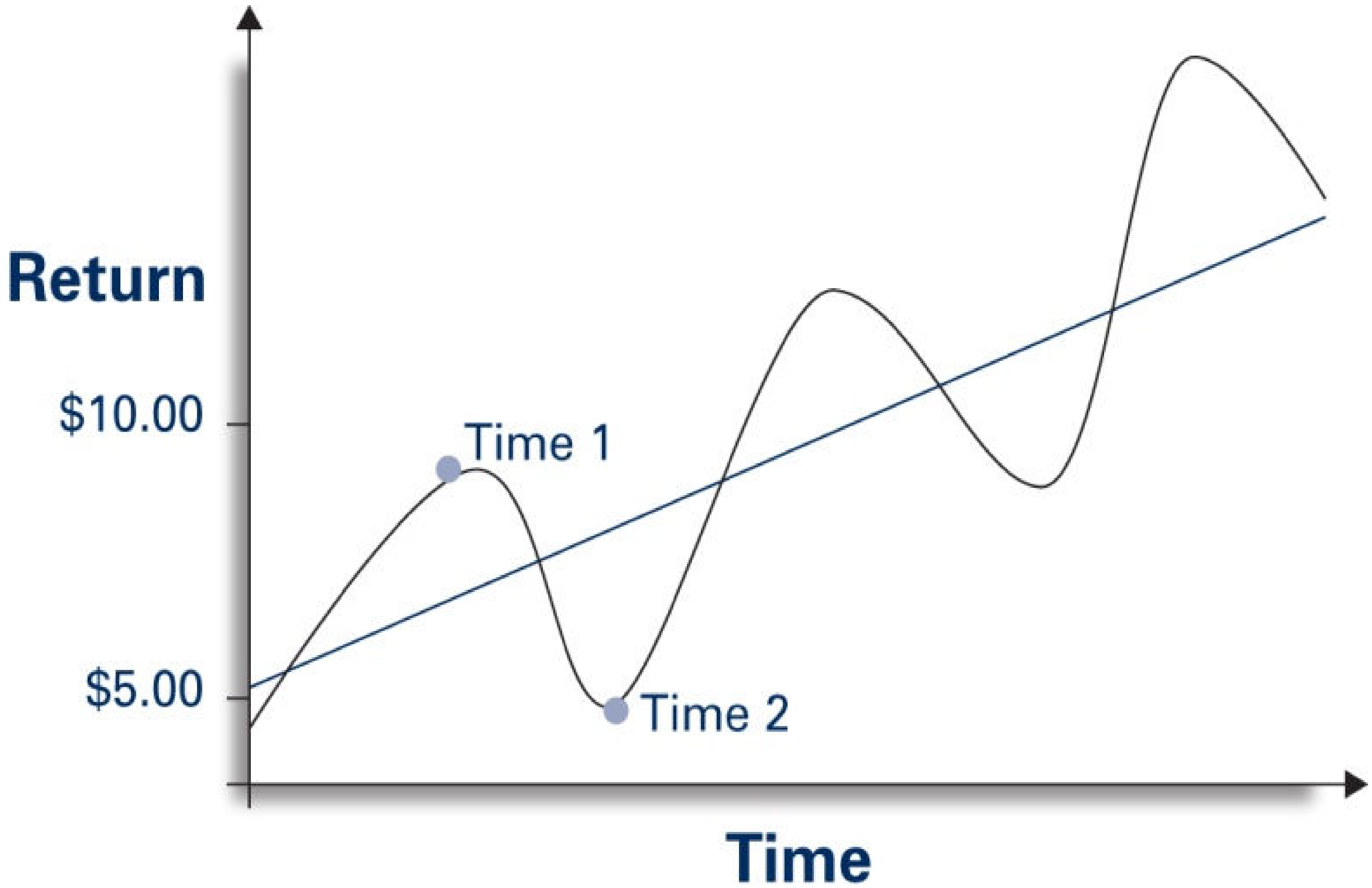


Centreboard Strategy

Active Management;

1. Roll Down
2. Lock in gains and roll on

Roll down



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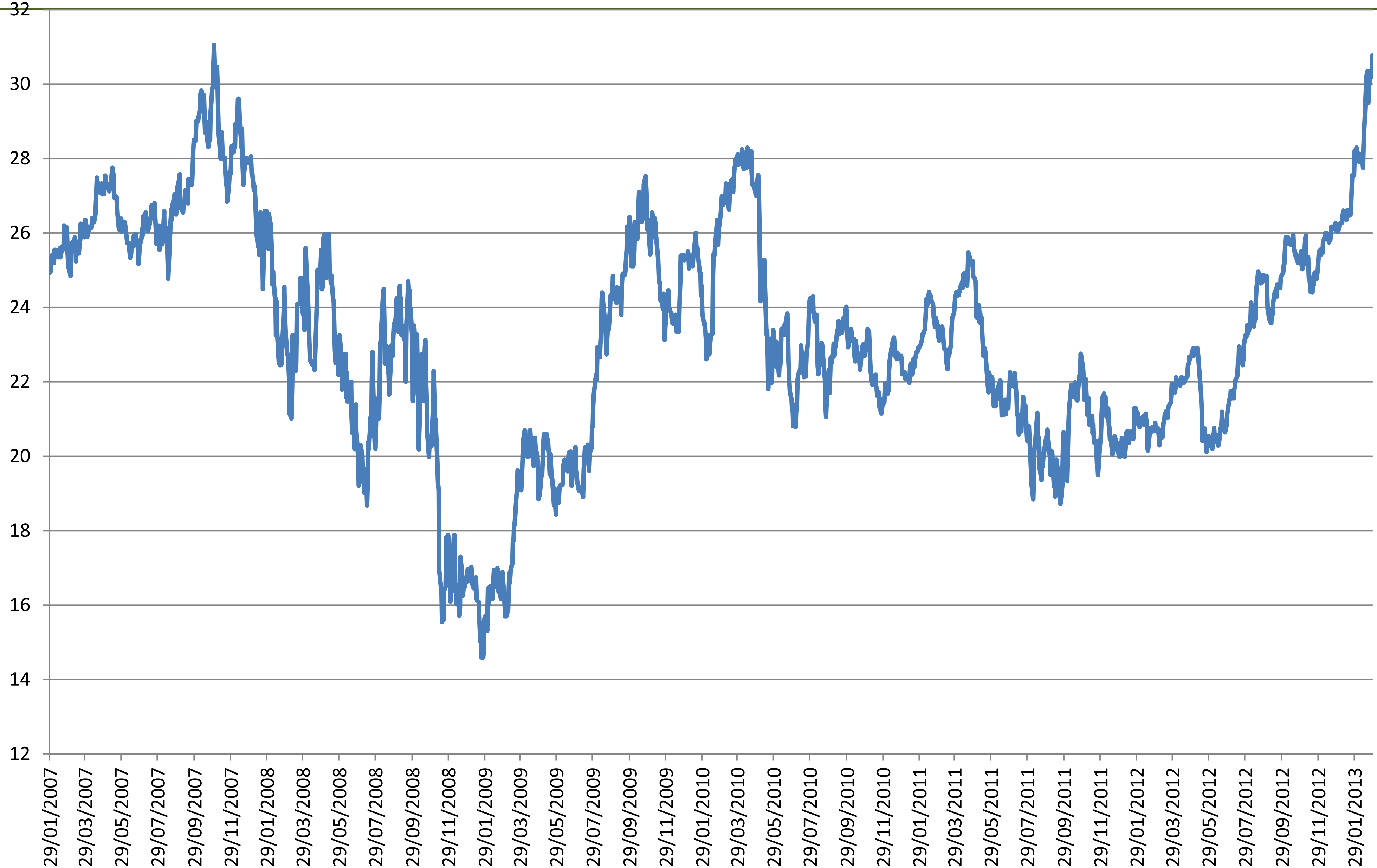
Westpac (WBC) Example



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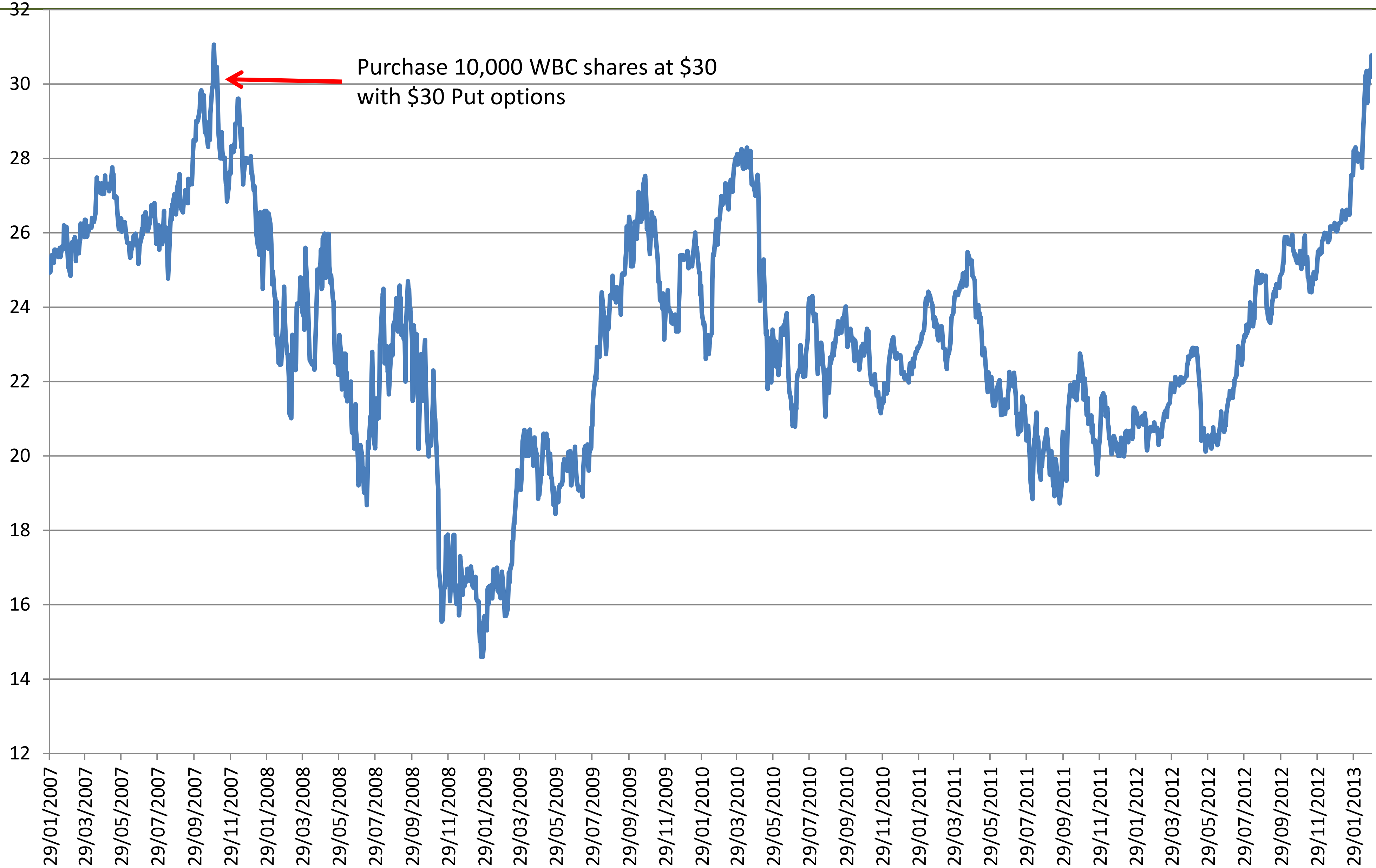

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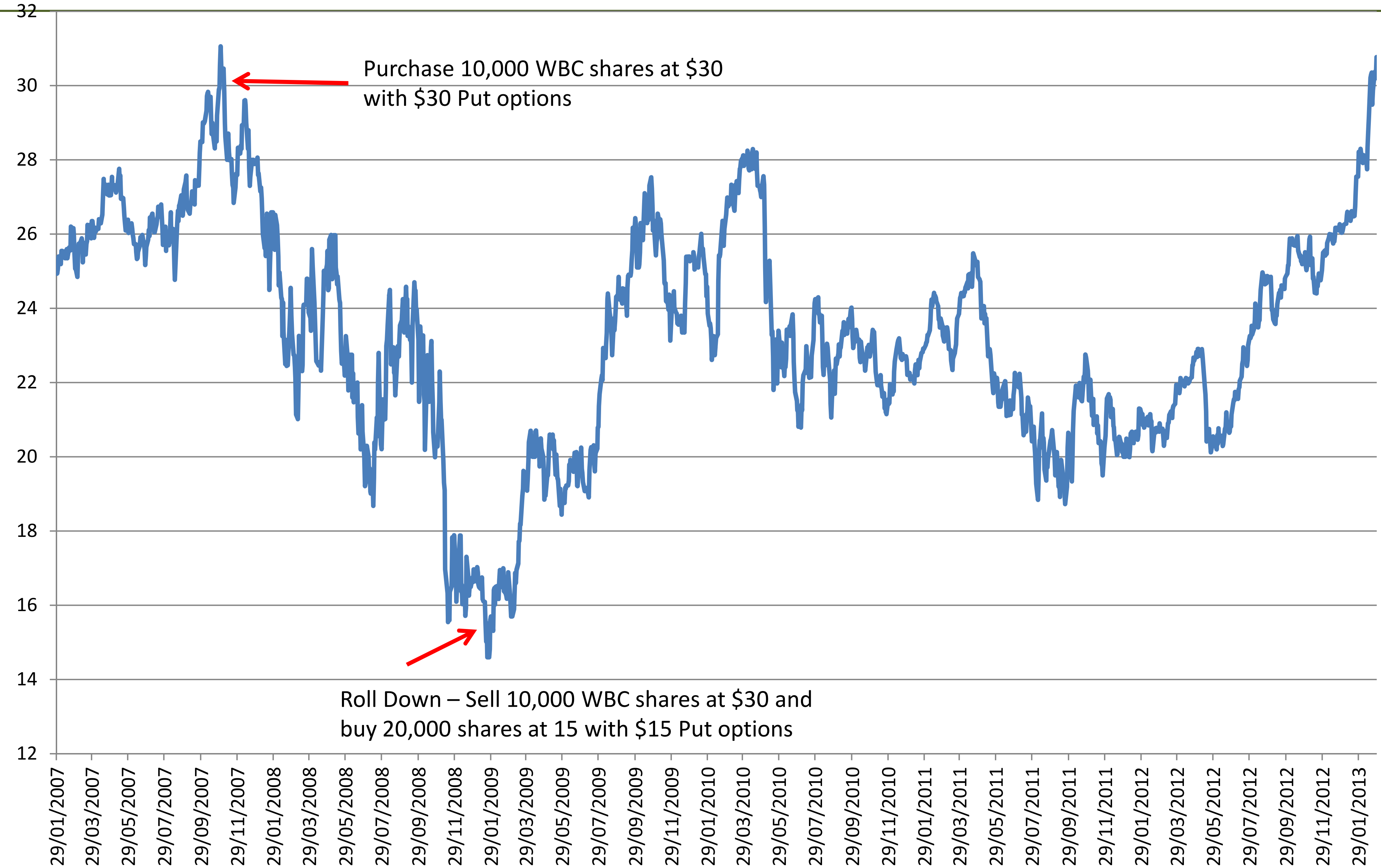

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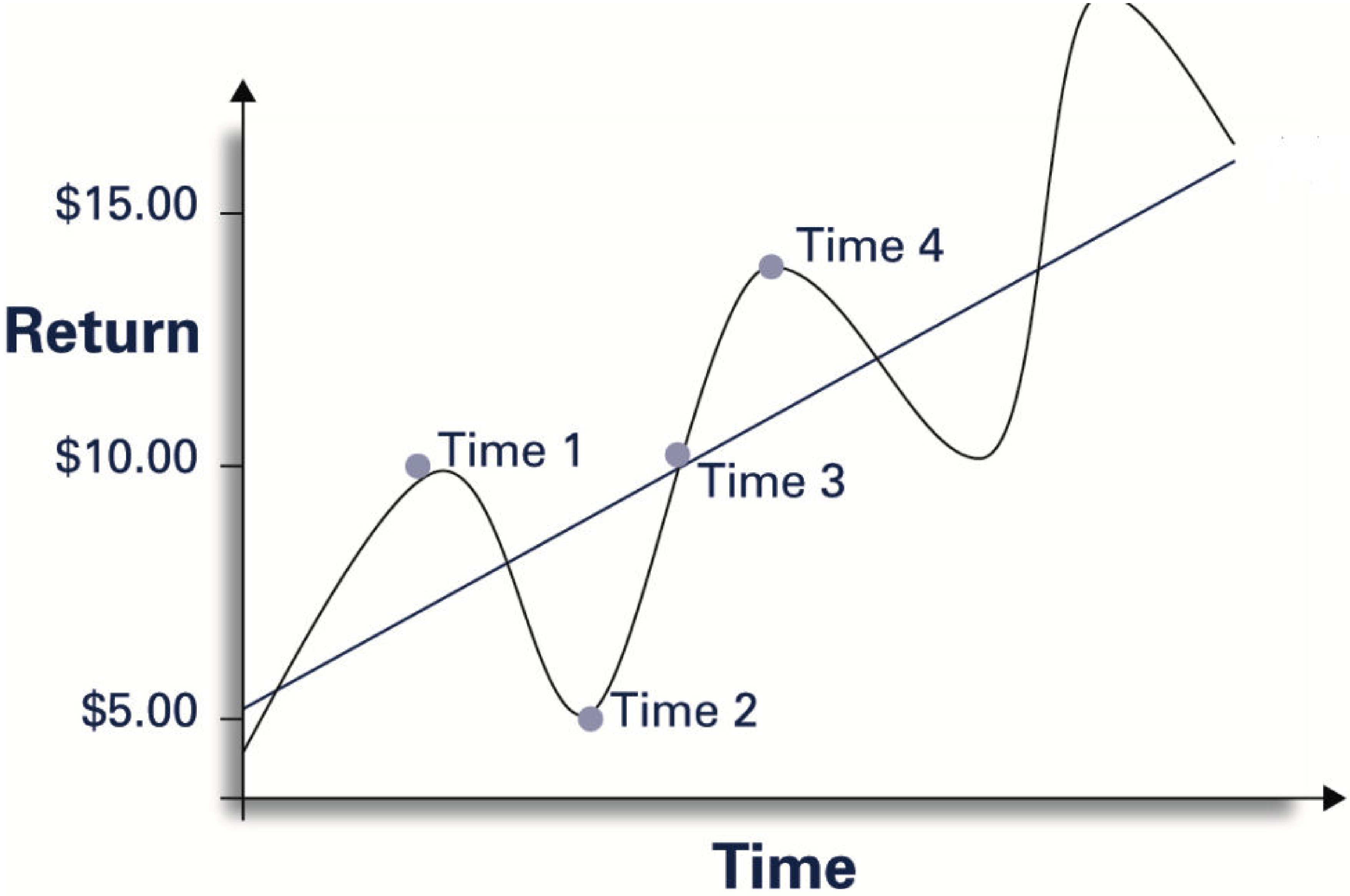
Lock in gains



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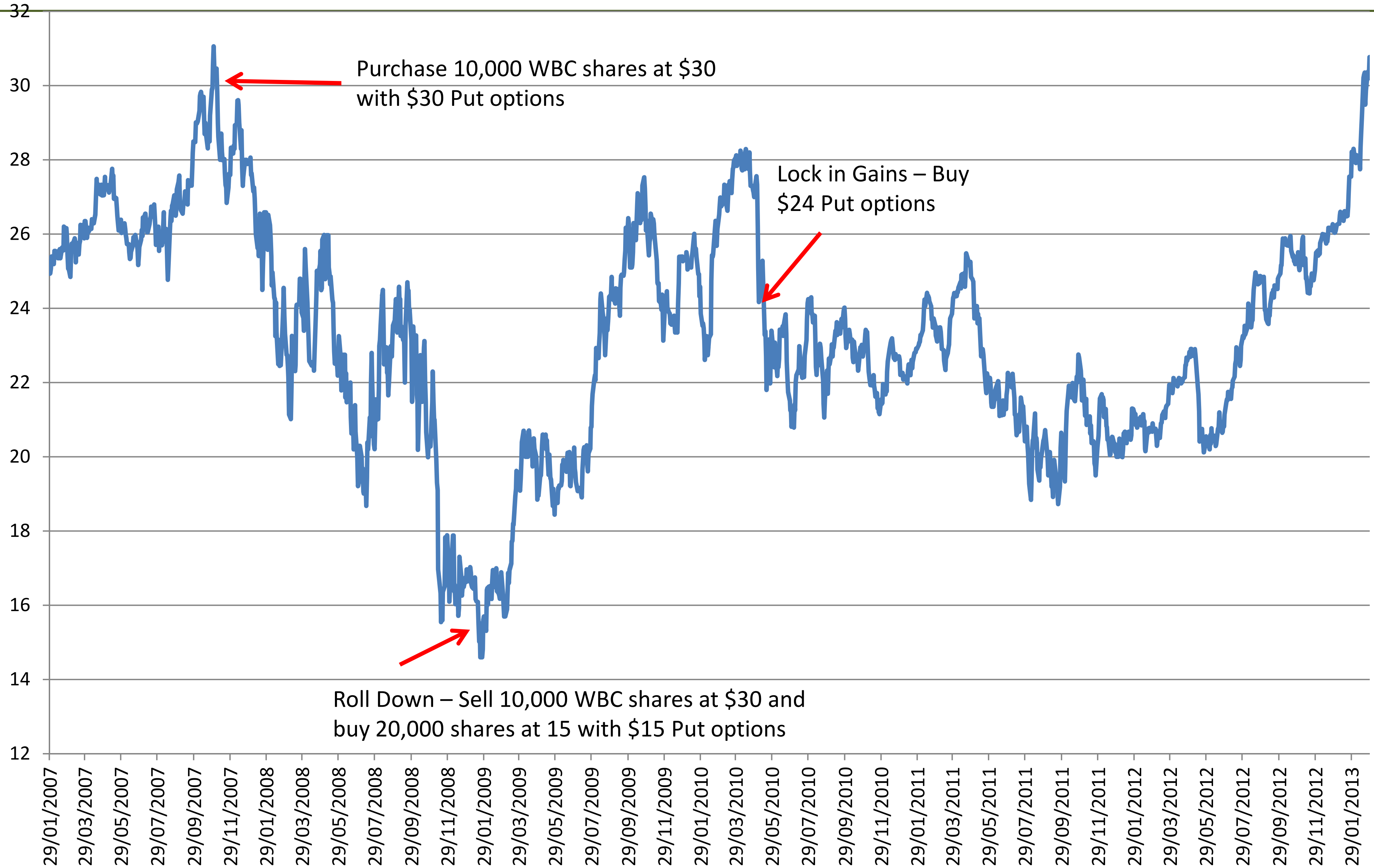

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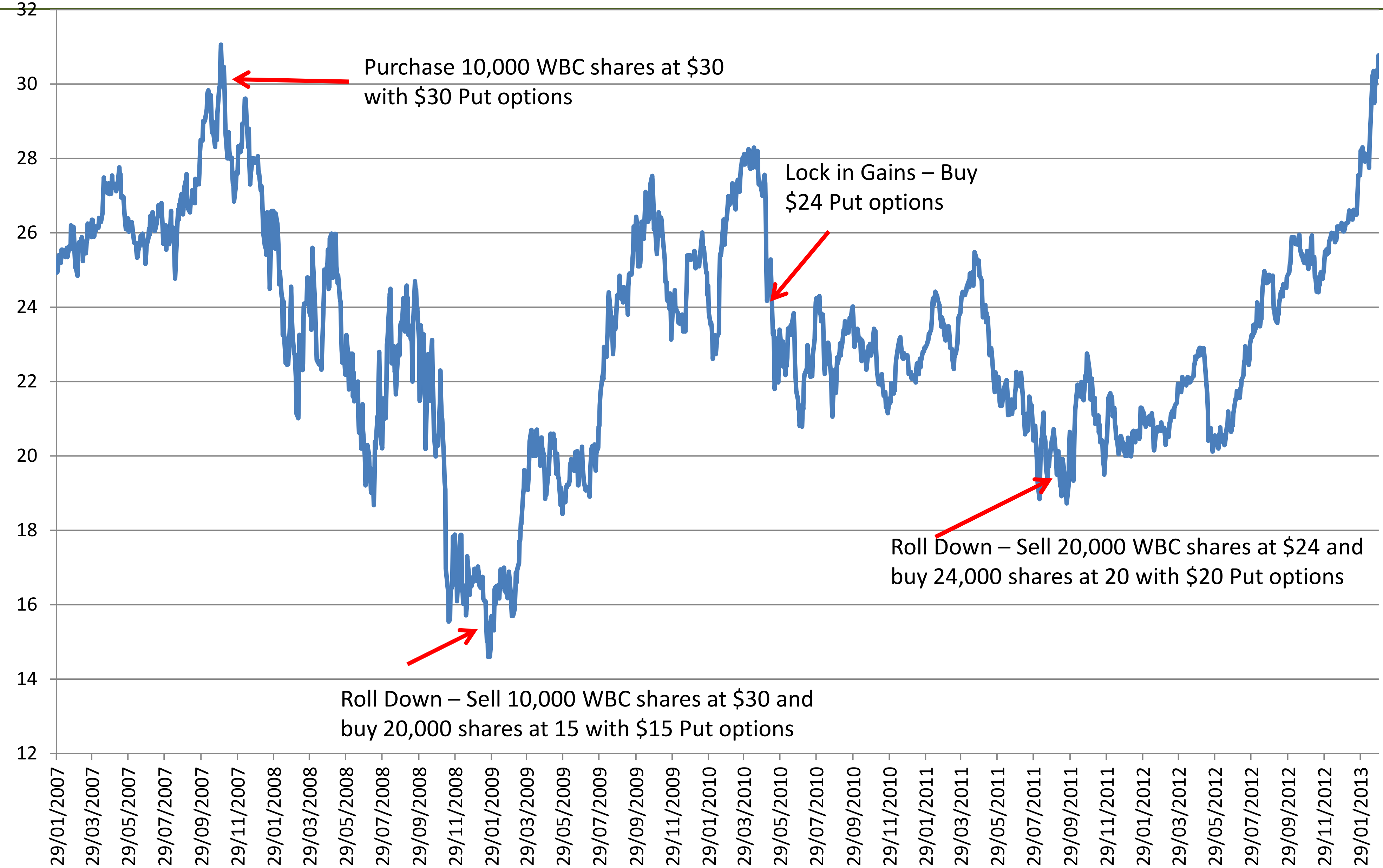

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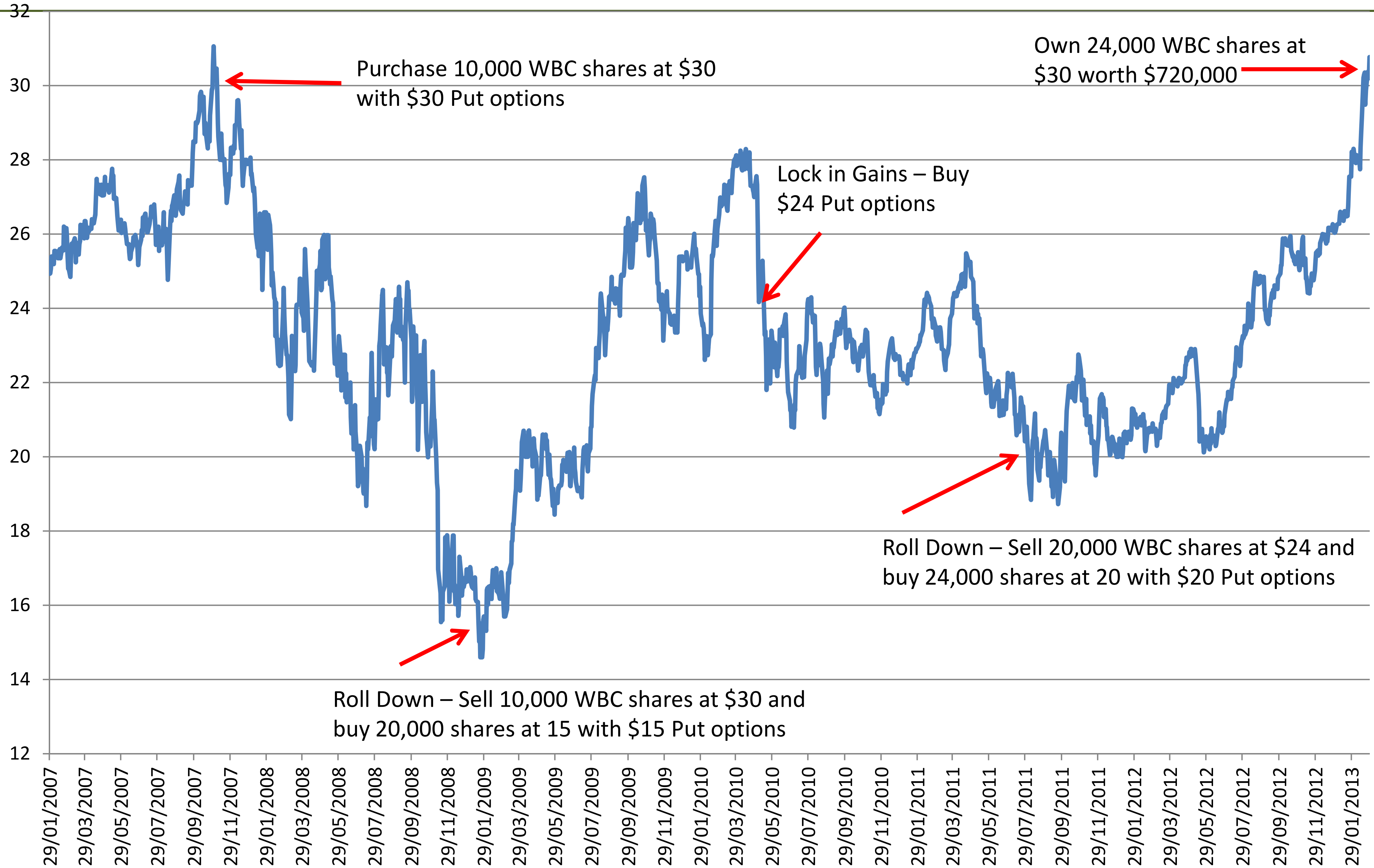

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Centreboard Strategy

“AN INVESTMENT IN KNOWLEDGE PAYS THE HIGHEST DIVIDEND”

Benjamin Franklin

BUT ONLY WHEN THAT KNOWLEDGE IS APPLIED!

Marcel Collignon

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