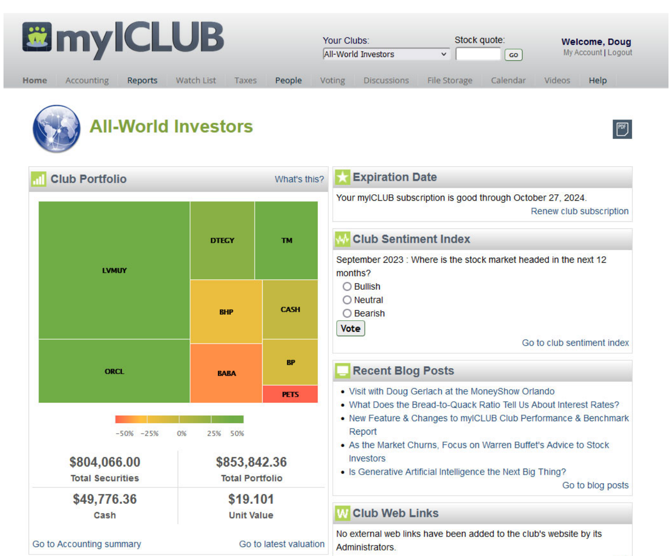
Investment Club Portfolio Tune-Up

DOUG GERLACH • MYICLUB.COM • NOVEMBER 2024



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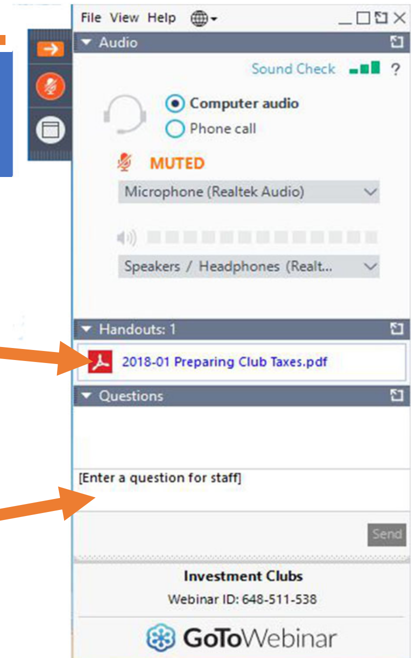
Handout & Questions

Handout in PDF format is available in Handouts tab.

Type questions in Questions box.



DOUG'S RULES OF PORTFOLIO CONSTRUCTION FOR INVESTMENT CLUBS

DEVELOP SPECIFIC, TANGIBLE PORTFOLIO GUIDELINES

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1. Get in the Market & Stay in the Market

- Remain 100% invested in stocks at *all times*.
  - Don't sit on cash – withdrawals can be handled by selling your biggest losers or transferring shares of big winners.
- Market & economic cycles give you opportunities if your approach is truly long-term.
- Most market gains come in just few days in a year (in 2023, almost all gains came from just 6 days).
  - Missing those big moves reduces returns considerably.
- Waiting out market's doldrums is more effective than trying to guess when to get in/out.

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2. Keep Club Portfolios Simple

- **Invest only in stocks & avoid arcane/problematic investments**:
  - Real Estate Investment Trusts (REITs).
  - Business Development Companies (BDCs).
  - Publicly-Traded Partnerships (PTPs) & Master Limited Partnerships (MLPs).
  - Commodities or Exchange Traded Funds (ETFs) that hold commodities.
  - Cryptocurrency.
  - Any ETFs or mutual funds (unless portfolio advantages are well-articulated as part of strategy & overcome accounting issues).
- Any of these can complicate tax preparation & unit value accounting.
  - *Sell before 12/31 to prevent future tax preparation hassles.*

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3. Keep Club Portfolios Concentrated

- Hold no stock that's less than 3% of total portfolio.
  - Even if these perform well, won't significantly affect returns.
- 20-30 well-chosen stocks delivers optimal return/risk in diversified portfolio.
  - Owing lots of stocks effectively turns portfolio into index fund & prevents it from outperforming broader market.
  - Very large (>$1M) portfolios may add more.
  - # of club members may also affect max # of stocks covered.
- Concentration forces members into **making good choices** about stock picks & prevents **lackadaisical decision-making**.

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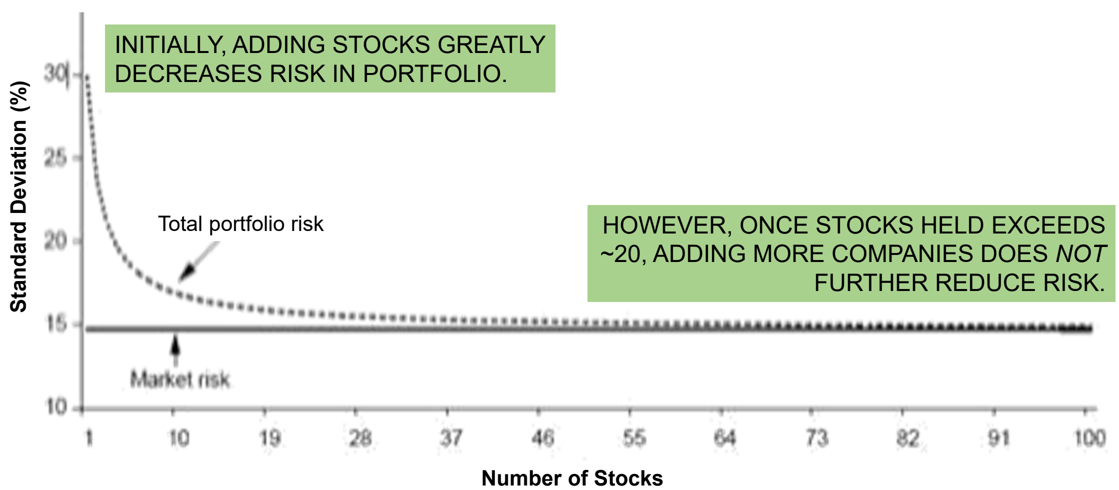
Total Portfolio Risk as Function of # of Stocks



Source: Dresdner Kleinwort Macro Research

4. Diversify by Company Size

- Diversify by size of revenues to include small, midsized & large companies.
  - Midsized company revenues between $1B and $10B.
- BI suggests 25% small, 50% mid, 25% large.
  - This is good target even if never precisely achieved.
- Deviate from this plan only with well-conceived, thoughtful strategy that sets custom target.

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Characteristics of Company Sizes

- Micro < $100 Million. — *More speculative.*
- Small < $1 Billion.
- Mid >$1 and < $10 Billion. — *Sweet spot for total return.*
- Large < $50 Billion. — *Add stability + dividends.*
- Mega > $50 Billion. — *May not provide enough growth to drive prices.*

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5. Diversify by Sector & Industry

- Must include healthy allocation of sectors in each **Super Sector**: Defensive, Sensitive, & Cyclical.
  - Target minimum of 15% in each Super Sector.
- Don't need to include every **Sector**, but try to include as many as possible to represent broad swath of US economy.
  - Real Estate, Energy, & Utilities sectors may be avoided in club/BI-style portfolios.
- Include many divergent **Industries**.
  - Avoid companies in overlapping or adjacent industries.
  - Target no industry less than 3% or more than 15%.

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Super Sectors & Sectors

Cyclical	Sensitive	Defensive
Basic Materials	Communication Services	Consumer Defensive
Consumer Cyclical	Industrials	Healthcare
Financial Services	Technology	Utilities*
Real Estate*	Energy*	

** Don't often fit the BI model or are not suitable for investment clubs.*

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6. Keep Focus on Growth

- Disciplined approach to investing (using SSG) is key to performance.
- BetterInvesting's 3 key objectives to outperform market over time:
  1. Capital appreciation driven by fundamental growth.
  2. Value from buying at reasonable prices.
  3. Income from dividends.
- Straying from these priorities can lead to underperformance.
  - Seek minimum average EPS growth of 10-12% (so appreciation exceeds market return).
  - If too many stocks are slow-growth, dividends won't lift returns enough.
- Treat club portfolio like growth mutual fund & thus allow members to accommodate club in their personal portfolio approach.

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7. Balance Risk & Return

- **Portfolio Beta** gives idea of overall volatility of entire portfolio.
  - **β= 1.0**: Portfolio sensitivity equivalent to market.
  - **β> 1.0:** More sensitive to volatility risk than market.
  - **β< 1.0**: Less sensitive to volatility risk than market.
  - **β< 0**: Inverse relationship between portfolio sensitivity & market (e.g. gold).

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What Beta Should Clubs Strive For?

- Weighted Average **Portfolio Beta of 1.10** is good target.
  - Given market dynamics (tendency of market to move upwards over long term), portfolio beta should be greater than 1.0 if goal is to outperform broad market.
- Portfolio beta much greater than 1.1 may cause discomfort when market reverses course.
- Portfolio beta below 1.0 will tend to deliver lower returns than market over time (though portfolio will see less decline during market reversals).

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8. Maintain Active Management

- Avoid tendency to hold on to underperforming or uncertain companies for too long.
- Better to take action **too soon/too often** rather than **too late**.
- Use club's portfolio construction guidelines as fuel for dealing with stocks that have uncertain prospects.
- Use tax harvesting to reduce overweight positions.
- Use "Challenge" approach to swap underperformers for stocks with greater potential.

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Investment Club Portfolio Tune-Up

ANY OPINIONS OFFERED ARE THOSE OF DOUG GERLACH, AND DO NOT REPRESENT THE VIEWS OF BETTERINVESTING OR ICLUBCENTRAL. CONDUCT YOUR OWN STOCK STUDIES AND RESEARCH BEFORE MAKING DECISIONS ABOUT YOUR PORTFOLIO.

What I Won't Address

- Tax considerations (though important in making wise moves).
- Past performance (since whether or not stock is in gain or loss column is largely irrelevant to future potential).
- Potential fundamental problems (these are easy to spot.
  - Determining if long-term prospects are good requires research & experience.
  - Don't default to "hold" when you are uncertain.
- Non-club issues:
  - Individual investor portfolios don't always face same constraints.

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Define Your Portfolio Approach

- There is no "one size fits all" approach to portfolio construction.
- Comments come with 3 labels as outlined in my "rules":
  - **Good**, **Caution**, **Warning**.
- Few "absolutes," but hopefully talking points will help club examine & re-set portfolio construction guidelines that fit objectives.
- Having practical goals gives members something to work towards.

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Club Composition

- 19 members.
- 14 companies.
- Located in Delaware.
- Founded in 2017.

- Caution: Holding more than 14 companies could be good for overall risk/return of portfolio.

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Portfolio Holdings

Apple (AAPL)	4.8%
Acme United (ACU)	3.7%
Amazon.com (AMZN)	18.5%
AstraZeneca PLC (AZN)	4.7%
Caterpillar (CAT)	8.4%
Carnival Corp (CCL)	3.7%
Direct Digital Holdings (DRCT)	2.4%
Inmode (INMD)	5.3%
The Duckhorn Portfolio (NAPA)	3.7%
Netflix (NFLX)	5.1%
Nvidia (NVDA)	19.5%
Pure Cycle (PCYO)	3.9%
Qualcomm (QCOM)	4.9%
Visa (V)	3.7%
CASH	**7.7%**

- Good: No arcane/problematic investments.
- Warning: Cash is high (7.7%).
- Caution: 1 slightly underweight position (2.4%).
- **Note**: NAPA agreed to be acquired on 10/1/24 for $11.10/share – consider selling now instead of waiting for deal to conclude (since upside is very limited).

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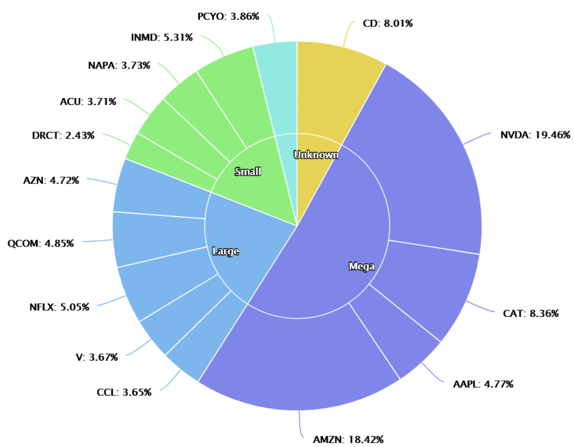
Diversification by Company Size



- Warning: No midsized companies.
- Warning: Mega & large over-represented.
- Caution: Small slightly under-represented.

Excludes Cash (but not CD).

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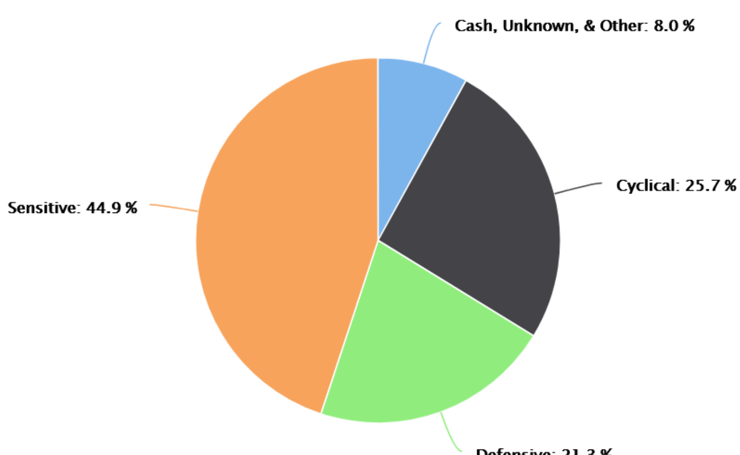
Diversification by Super Sector



- Good: All 3 Super Sectors represented in good allocations.

Excludes Cash (but not CD).

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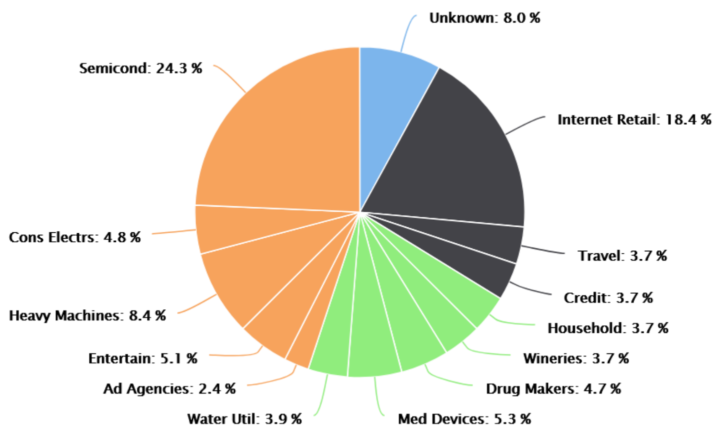
Diversification by Sector & Industry



- Caution: Semiconductor industry overweighted (Nvidia & Qualcomm) (24.3%).
- Good: All sectors except Basic Materials represented.

Excludes Cash (but not CD).

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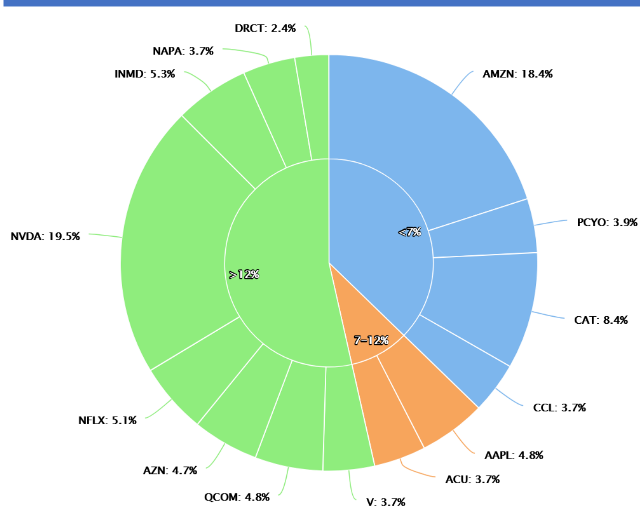
Diversification by EPS Growth Rate



- Good: Faster growing companies make up bulk of portfolio.
- Note: Using linked SSGs for growth projections for most (but not all) companies.
- Note: Sales Growth Rate Diversification is similar.

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Portfolio Beta

Weighted Average Portfolio Beta: 1.11

Ticker	Security	Shares owned	Price/share	Market value	% of Total	5-year Beta	Beta Weight
AAPL	Apple Inc	23.0	$231.30	$5,319.90	4.4%	1.24	0.05
ACU	Acme United Cp	100.0	$43.60	$4,360.00	3.6%	0.66	0.02
AMZN	Amazon.com Inc	111.0	$187.54	$20,816.94	17.1%	1.15	0.20
AZN	AstraZeneca PLC	68.0	$78.10	$5,310.80	4.4%	0.47	0.02
CAT	Caterpillar Inc	24.0	$393.95	$9,454.80	7.7%	1.10	0.09
CCL	Carnival Corp	222.0	$20.21	$4,486.62	3.7%	2.69	0.10
CD	CD	9,000.0	$1.00	$9,000.00	7.4%	0.00	n/a
DRCT	Direct Digital Holdi	1,292.0	$3.61	$4,664.12	3.8%	0.00	n/a
INMD	Inmode Ltd	352.0	$16.65	$5,860.80	4.8%	2.17	0.10
NAPA	The Duckhorn Portfol	721.0	$10.97	$7,909.37	6.5%	0.00	n/a
NFLX	Netflix Inc	8.0	$713.00	$5,704.00	4.7%	1.26	0.06
NVDA	Nvidia Corp	180.0	$138.07	$24,852.60	20.4%	1.67	0.34
PCYO	Pure Cycle Corp	402.0	$10.62	$4,269.24	3.5%	0.93	0.03
QCOM	Qualcomm Inc	32.0	$178.04	$5,697.28	4.7%	1.28	0.06
V	Visa Inc	15.0	$280.68	$4,210.20	3.5%	0.96	0.03
Totals				**$121,916.67**			**1.11**

- Good: Weighted Portfolio Beta is 1.11.

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QUESTIONS?

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FEM UNLIMITED

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Club Composition

- 25 members.
- 28 companies.
- Located in California.
- Founded in 2000.

- Good: 28 companies is good for size of portfolio & number of members.
- Have reduced securities from 45 to 28 based on our last portfolio tune-up webinar.
- QQQ is major holding, but club is delaying selling due to capital gains.

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Portfolio Holdings

Apple Inc (AAPL)	12.3%	Nvidia (NVDA)	11.9%
Amazon.Com (AMZN)	6.3%	Proctor & Gamble (PG)	1.1%
Berkshire Hathaway (BRKB)	6.0%	QQQ (QQQ)	4.6%
Caterpillar (CAT)	2.6%	QXO Inc (QXO)	0.1%
Costco (COST)	5.7%	Royal Caribbean (RCL)	1.1%
Alphabet Inc (GOOGL)	2.1%	Raytheon Tech (RTX)	0.8%
Home Depot (HD)	1.2%	Shopify Inc (SHOP)	2.4%
IBM (IBM)	2.2%	TJX Companies (TJX)	2.8%
Intel Corp (INTC)	0.4%	Travelers (TRV)	0.3%
Johnson & Johnson (JNJ)	1.0%	Tesla Motors (TSLA)	2.6%
Medtronic (MDT)	0.9%	United Rental (URI)	9.9%
Meta Platforms (META)	2.0%	Wal-Mart (WMT)	3.5%
Netflix (NFLX)	14.4%	XPO Logistics (XPO)	1.4%
		Cash	0.5%

- Warning: 17 underweight positions below 3% (0.1% - 2.8%).
- Warning: 1 ETF (QQQ) makes up 4.6% of portfolio.
- Good: Cash is good (0.5%).
- Caution: WMT (3.5%) & COST (5.7%) have significant overlap.
- Caution: INTC (0.4%) & NVDA (11.9%) have significant overlap.
- Caution: BRK.B (6.0%) & TRV (0.3%) have significant overlap.
- **Note**: Intel & Facebook/Meta included twice on Valuation.

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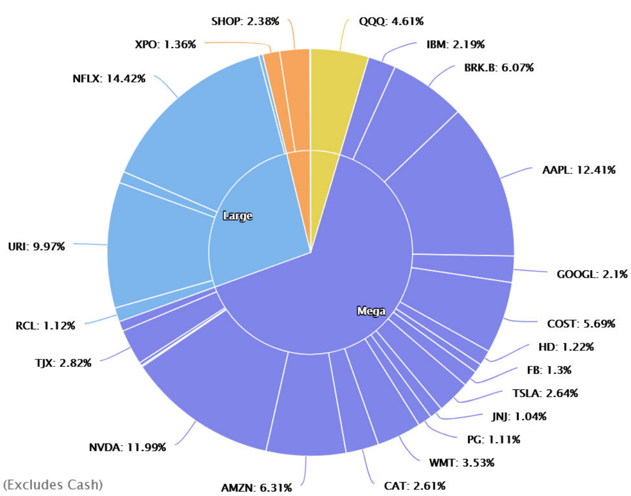
Diversification by Company Size



(Excludes Cash)

- Warning: No small companies.
  - 1 micro company (0.1%).
- Warning: Only 2 midsized companies (3.9%).
- Warning: Mega & large over-represented.
  - QQQ is mostly large & mega.

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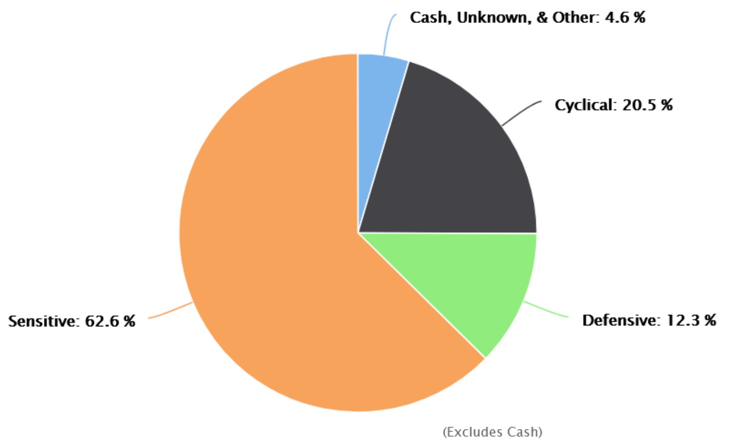
Diversification by Super Sector



- Caution: Defensive super sector slightly light at 12.3%.

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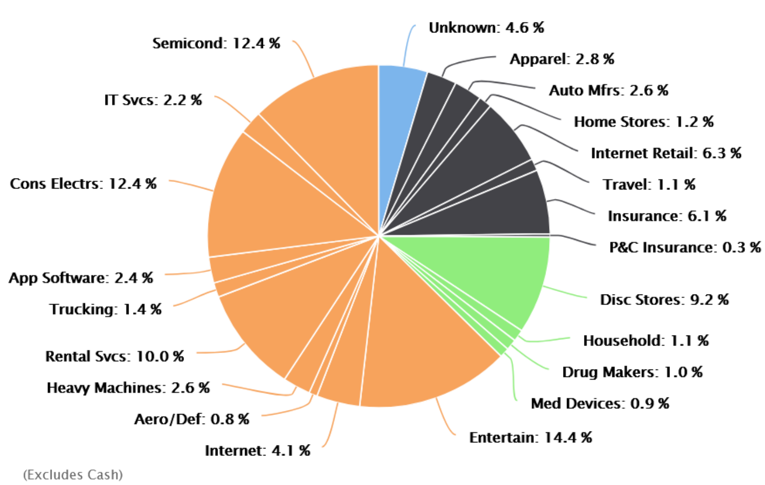
Diversification by Sector & Industry



- Good: All sector represented except Basic Materials.
- Caution: Technology sector overweighted at 34.0% (when adding QQQ to individual stocks).
- Caution: Healthcare sector underweighted (1.9%).

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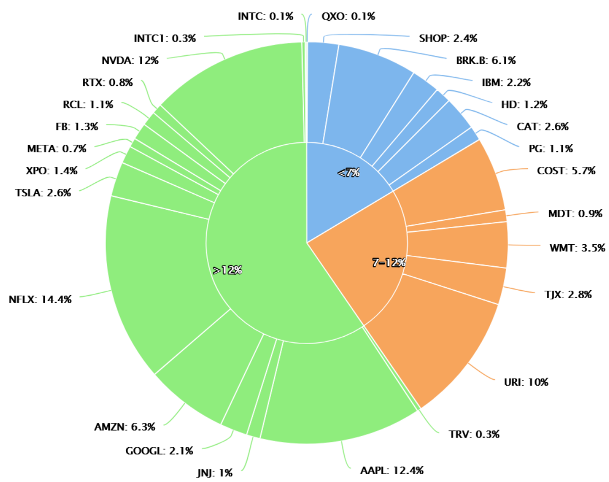
Diversification by EPS Growth Rate



- **Good**: Faster growing companies make up bulk of portfolio.
- **Note**: Using analysts estimates for growth projections—no SSGS are linked.
- **Note**: Sales Growth is similar.

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Portfolio Beta

Weighted Average Portfolio Beta: 1.23

Ticker	Security	Shares owned	Price/share	Market value	% of Total	5-year Beta	Beta Weight
AAPL	Apple Inc	843.3530	$231.30	$195,067.55	12.0%	1.24	0.15
AMZN	Amazon.Com Inc	536.0000	$187.54	$100,521.44	6.2%	1.15	0.07
BRK.B	Berkshire Hathaway I	209.0000	$459.98	$96,135.82	5.9%	0.87	0.05
CAT	Caterpillar	105.8629	$393.95	$41,704.69	2.6%	1.10	0.03
COST	Costco Whsl Corp	101.7022	$889.76	$90,490.55	5.6%	0.80	0.04
FB	FaceBook	36.0000	$590.42	$21,255.12	1.3%	1.21	0.02
GOOGL	Alphabet Inc	200.4815	$164.96	$33,071.43	2.0%	1.04	0.02
HD	Home Depot	47.5145	$415.42	$19,738.47	1.2%	1.00	0.01
IBM	International Busine	156.8176	$235.26	$36,892.91	2.3%	0.70	0.02
INTC	Intel Corp	75.8176	$23.44	$1,777.16	0.1%	1.02	n/a
INTC1	Intel	172.0350	$23.44	$4,032.50	0.2%	1.02	n/a
JNJ	Johnson & Johnson	101.6567	$161.60	$16,427.72	1.0%	0.53	0.01
MDT	Medtronic, plc	157.5130	$90.01	$14,177.75	0.9%	0.84	0.01
META	Meta Platforms Inc	19.1375	$590.42	$11,299.16	0.7%	1.21	0.01
NFLX	Netflix Com Inc	322.0000	$713.00	$229,586.00	14.1%	1.26	0.18
NVDA	Nvidia Corp	1,563.6392	$138.07	$215,891.66	13.3%	1.67	0.22
PG	Proctor & Gamble	101.8764	$172.51	$17,574.70	1.1%	0.42	n/a

- **Caution**: Weighted Portfolio Beta somewhat high at 1.23.

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Portfolio Holdings Also in QQQ

Apple Inc (AAPL)	12.3%	Nvidia (NVDA)	11.9%
Amazon.Com (AMZN)	6.3%	Proctor & Gamble (PG)	1.1%
Berkshire Hathaway (BRKB)	6.0%	QXO Inc (QXO)	0.1%
Caterpillar (CAT)	2.6%	Royal Caribbean (RCL)	1.1%
Costco (COST)	5.7%	Raytheon Tech (RTX)	0.8%
Alphabet Inc (GOOGL)	2.1%	Shopify Inc (SHOP)	2.4%
Home Depot (HD)	1.2%	TJX Companies (TJX)	2.8%
IBM (IBM)	2.2%	Travelers (TRV)	0.3%
Intel Corp (INTC)	0.4%	Tesla Motors (TSLA)	2.6%
Johnson & Johnson (JNJ)	1.0%	United Rental (URI)	9.9%
Medtronic (MDT)	0.9%	Wal-Mart (WMT)	3.5%
Meta Platforms (META)	2.0%	XPO Logistics (XPO)	1.4%
Netflix (NFLX)	14.4%	Cash	0.5%

- Warning: 57.6% of portfolio (9 companies) are also in QQQ.

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Dealing with QQQ

- QQQ is long-term holding, with $65K of unrealized capital gains.
- Club resists selling due to taxes that would be due on these gains, but would like to reduce exposure & focus on individual stocks.
- No need to sell all at once—here are some ideas.

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Capital Gain/Loss Harvesting?

- Harvest capital losses to offset realized gains.
  - However, club's realized gains for YTD 2024 due to stocks sold earlier in year total $30K.
- Currently holding securities with $12K-$13K in unrealized losses (INTC & QXO).
  - Could be prudent to sell these now to realize losses, which would offset some of club's realized gains in other stocks YTD.
  - Can revisit in 31 days to consider repurchasing sold stocks.

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Strategies for Dealing with QQQ

1. **Continue to hold** – but manage portfolio in order minimize risk from overexposure to large-cap tech.
2. As members fully withdraw, **transfer shares of QQQ** to them instead of cash.
   - Capital gains from QQQ shares transferred would be deferred, then held in club's books until other members eventually withdraw & get assigned their share of realized QQQ gains.
3. In future, as other companies drop in price & become sale candidates, **sell some QQQ at same time to offset gains & losses**.

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QUESTIONS?

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IT'S R TURN

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Club Composition

- 6 members.
- 8 companies.
- Located in Washington.
- Founded in 1997.

- Caution: Holding more companies could be good for overall risk/return of portfolio.

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Portfolio Holdings

Apple (AAPL)	29.7%
Amphastar Pharma (AMPH)	0.9%
Amazon.com (AMZN)	29.5%
Costco Wholesale (COST)	5.8%
Alphabet (GOOG)	1.3%
Microsoft (MSFT)	15.6%
United States Lime (USLM)	4.8%
VISA (V)	12.0%
Cash	**0.6%**

- Warning: 2 overweight positions (AAPL 29.7% & AMZN 29.5%).
- Warning: 2 significantly underweight positions below 3% (AMPH 0.9%, GOOG 1.3%).
- Good: No arcane/problematic investments.
- Good: Cash is good 0.6%.

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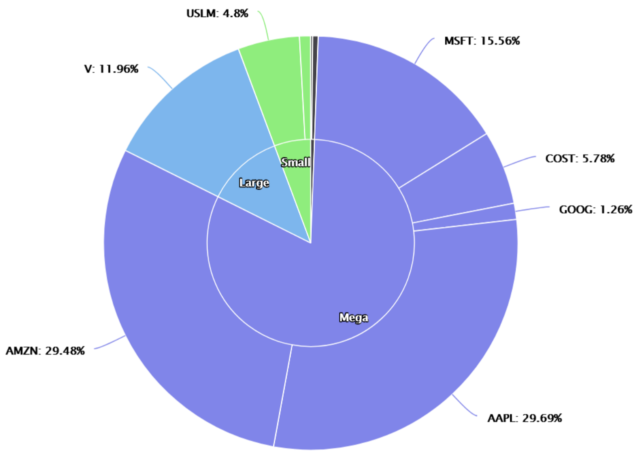
Diversification by Company Size



- Warning: Only 2 small companies.
- Warning: No midsized companies.
- Warning: Mega & large over-represented.

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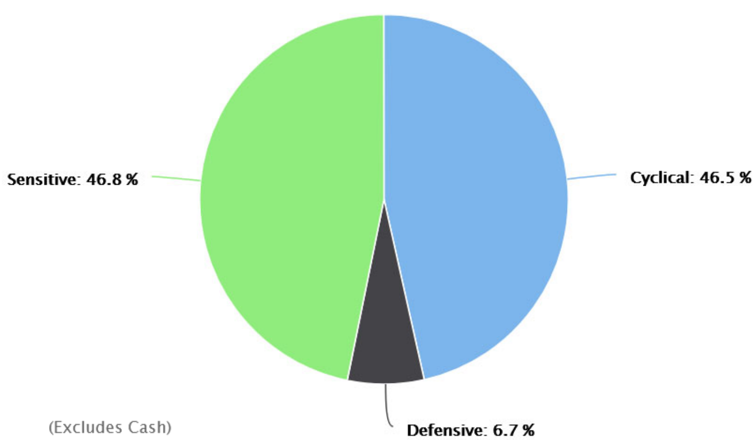
Diversification by Super Sector



- Caution: Defensive Super Sector underweighted (6.7%).
- Caution: Sensitive & Cyclical Super Sectors overweighted (~46% each).

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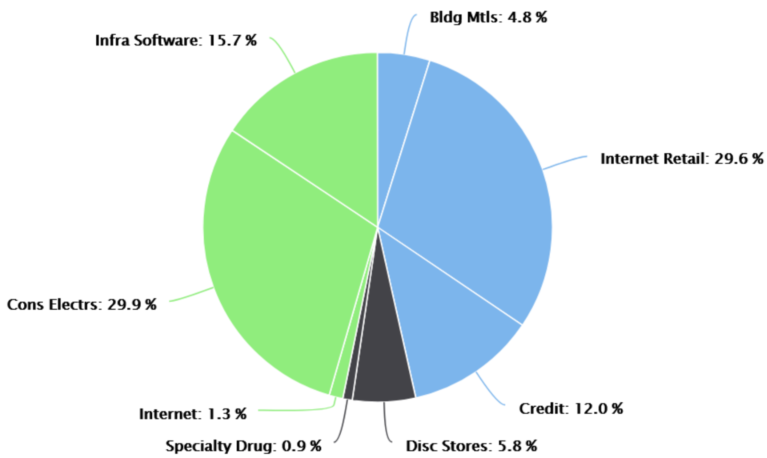
Diversification by Sector & Industry



- Good: All sectors represented except Industrials.
- Caution: Healthcare sector underweighted (0.9%).
- Caution: Tech (45.5%) & Consumer Cyclical (29.6%) sectors overweighted.
- Caution: Internet Retail (29.6%) & Consumer Electronics (29.9%) industries overweighted.

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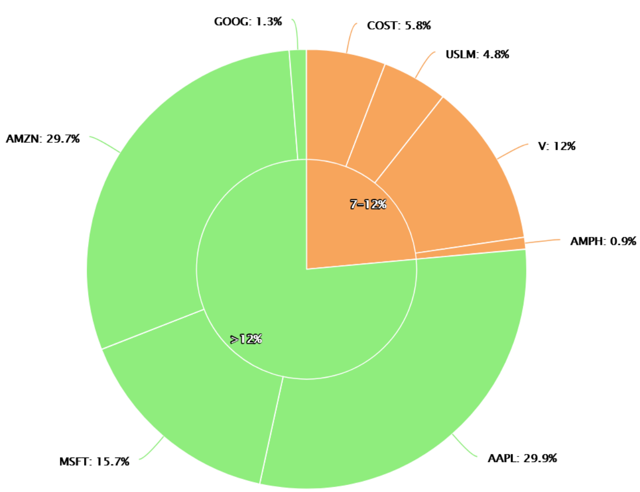
Diversification by EPS Growth Rate



- Good: Faster growing companies make up bulk of portfolio.
- **Note**: Half of all of stocks using analysts estimates for growth projections, other half using linked SSGs.
- **Note**: Sales growth rate diversification similar.

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Portfolio Beta

Weighted Average Portfolio Beta: 1.07

Ticker	Security	Shares owned	Price/share	Market value	% of Total	5-year Beta	Beta Weight
AAPL	Apple Inc	140.0	$231.30	$32,382.00	29.8%	1.24	0.37
AMPH	Amphastar Pharmaceut	20.0	$49.29	$985.80	0.9%	0.83	0.01
AMZN	Amazon.com Inc	169.0	$187.54	$31,694.26	29.2%	1.15	0.33
COST	Costco Wholesale	7.0	$889.76	$6,228.32	5.7%	0.80	0.05
GOOG	Alphabet Inc	8.0	$166.35	$1,330.80	1.2%	1.05	0.01
MSFT	Microsoft Corp	40.0	$419.14	$16,765.60	15.4%	0.90	0.14
USLM	United States Lime &	55.0	$101.35	$5,574.25	5.1%	0.84	0.04
V	VISA Inc	46.0	$280.68	$12,911.28	11.9%	0.96	0.11
Totals				**$107,872.31**			**1.07**

- Good: Weighted Portfolio Beta may be somewhat low at 1.07.

QUESTIONS?

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Need Stock Ideas?

StockCentral
Stock analysis tools, screener, sector & industry averages, ratio analyzer, technical charts, REIT analysis, dividend tools, & company reports with 10 years of data.
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Powerful & comprehensive tool for long-term-based stock screening, for beginner to advanced investors. Over 120 separate criteria, including long-term growth rates.
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