Venable Park Philosophy and Method

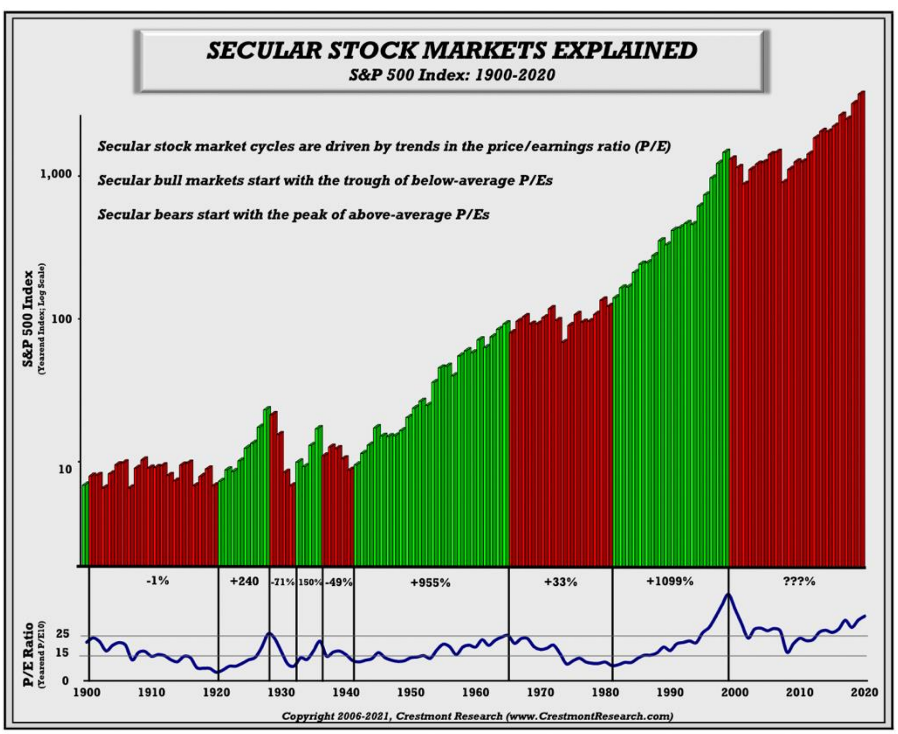
Facing facts

Until the stock market bubble burst in 2000, many investors believed that professional money managers were risk managers who moved in and out of asset markets according to market conditions and relative risk/reward assessments. "Since I am paying for professional money management," they thought, "I assume the managers will consider the risk to my capital and take my money out of harm's way when the risk becomes greater than any reasonable prospect of reward. After all, that's what I pay them for."

The hard lesson many investors have learned is that while down or "bear" markets are a regular phase of each market cycle, most managers have no proactive systems in place to protect capital from the predictable and recurring price declines that follow.

Simply put, the investment industry is a sales-driven culture where individual investors regularly bear the brunt of poor results stemming from poor risk management.

Investment service providers typically focus more on their scalability and asset collection goals than effective risk management for their clients. The larger a firm's assets under management, the more difficult it is for managers to move capital in and out of various markets or holdings without moving prices with them. Out of convenience and wilful blindness, most managers have adopted an unwavering, often passionate belief in passive, perpetual allocations to equities: "buy and hold."



The chart on the left from *www.crestmontresearch.com* shows that remaining 'long always' of risk assets can work reasonably well during prolonged secular bull periods (green) like world markets saw from 1920 to 1929 or from 1940 to 1965 or 1982 to 1999. However, it is not helpful during the intervening long secular bear phases (red) like 1900 to 1920, 1929 to 1940, or 1966 to 1982, or the one that we are presently working through that began in 2000.

Remaining perpetually invested in equities during secular bear periods is a painful, losing strategy with low to negative cumulative returns and lots of volatility and risk. Each time markets fall, the investor's net worth, patience and well-being plunge with them. Meanwhile, most managers and market commentators continue to insist that the losses are unexpected or unavoidable.

The problem with "long-term" time horizons

Traditional portfolio theory is premised on very long-time horizons. However, individual investors have finite life spans. Institutional theories of market returns over 20, 30 or 40 years are far too long to reflect the reality of most real-life investors. Most investors do not have the bulk of their savings to invest until they are in their 50's to 70's. By then, their time horizons for real-life purposes are much shorter. As a result, controlling risk to client capital becomes of primary importance. If investors suffer significant declines, they can face a serious risk of not having the money they need, even if market prices later recovered.

The past few years have demonstrated that passively riding market cycles up and down wastes precious time with adverse psychological and financial impacts. The math of loss is not kind; a loss of 50% requires a subsequent gain of 100% and usually many years to recover. Loss experiences cause investors to question their investment approach, their holdings, and their advisors. More than ever before, investors have become critical of the perceived value for management fees paid.

The Venable Park solution

We have developed a unique approach to manage the cost and volatility associated with investing in publicly traded markets to address these issues. Our process is based on prescribed allocation rules and objective quantitative filters that help to remove the extraneous noise of opinion and general market speculation. It is the discipline required to capture superior cumulative returns over a complete market cycle while minimizing losses.

To accomplish this, we adhere to the following founding principles:

1. **We are professional fiduciaries looking out for the best interests of our clients.** We do not participate in new issues, corporate underwriting or collect sales incentives of any kind. We are paid only by our clients directly.

2. **We manage individual, segregated accounts held in individual client names with a third party-chartered bank as the account custodian and broker.** The custodian works for our clients and us; we do not work for them.

3. **Each account is balanced with a tactical—not static— allocation mix** of fixed income (individual investment-grade bonds and bond pools), equities, currencies, and cash.

4. **We avoid company-specific risk by using indices and exchange-traded funds (ETFs) rather than individual common shares.** Stock analysis is a dubious activity based on financial statements that are purely retrospective and can be misleading or fraudulent in the information they present.

In addition, studies reveal bias on the part of company management and stock analysts to rate securities favourably at every price and continually forecast higher and higher earnings regardless of whether further gains are reasonable, and irrespective of whether the economy may be nearing its next recession where corporate assets typically plunge in price.

We have chosen to avoid the perils of individual company risk and management bias by utilizing ETFs and index units for our growth asset exposure. By removing the specific risk of individual company securities, we can focus on the big picture of market cycles and the relative risk to client capital at every stage.

5. **We continually and humbly take our risk measurements daily, weekly, and monthly to actively assess relative price risk through each market cycle phase.** We monitor money flow in and out of world markets and sectors, following the premise that "a rising tide lifts all boats," and vice versa.

6. **We are not mandated to remain long of equities. We can reduce the allocation to that asset class to zero** if our ruleset suggests price risk is too significant to justify continued exposure.

7. **We keep investment fees and costs low and completely transparent.** We charge one low annual management fee for our service, thus removing a significant drain on a client's invested capital.

8. **We are very attentive students of market history. History may not repeat itself, but investor behaviour does. We seek to learn from the classic mistakes of other periods and people.** We see investor psychology as one of the most dominant factors directing prices in financial markets. Each market is an auction where the participants bid based on individual perceptions of value, whether actual or anticipated; whether accurate, overly optimistic, or depressed. There is a distribution from strong hands to weak hands in each market cycle between the various market participants; this has always been so. We aim to move with the strong money flow and be earlier in and out than the masses.

In a nutshell

At Venable Park, we have developed a disciplined, unbiased set of rules regarding adding, removing, or leaving capital invested in a particular asset class or market.

We have created these rules to reduce the persuasion and noise of subjective market factors such as individual opinion, fear and greed. **We have learned that if we focus on controlling the downside, the upside will take care of itself**. We seek to capture the bulk of up-cycle gains while avoiding the majority of down-cycle losses. Or in general, as recommended by Wall Street trader Fred Schewd Jr. in 1940:

> *"When there is a boom and everyone is scrambling for common stocks, take all your stocks and sell them. Put the proceeds in the bank [T-bills]. No doubt, the stocks you sold will go higher. Pay no attention to this—just wait for the recession which will come sooner or later. When it gets bad enough to arouse the politicians to make speeches, take your money out of the bank [T-bills] and buy back the stocks. No doubt the stocks will go still lower. Again, pay no attention. Wait for the next boom. Continue to repeat this operation as long as you live, and you'll have the pleasure of dying rich.*
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> --Fred Schwed, Jr., (1940) Where Are the Customers' Yachts?