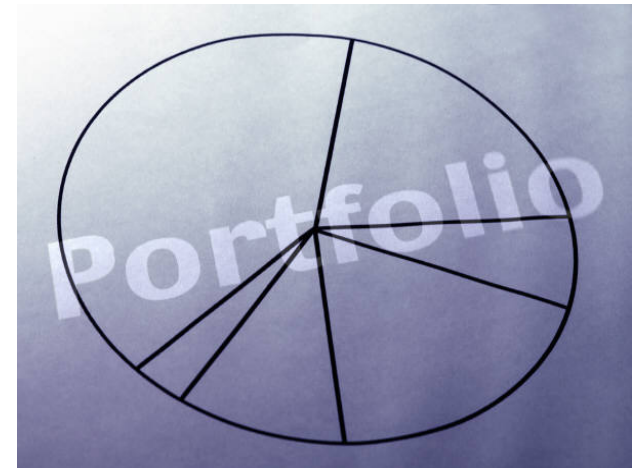




**Montréal
Exchange**

Only the...

PORTFOLIO MATTERS!



A core - satellite investment strategy

Toronto Stock Exchange | TSX Venture Exchange | **Montréal Exchange** | Natural Gas Exchange | Montréal Climate Exchange | Boston Options Exchange

Canadian Derivatives Clearing Corporation | TMX Datalinx | Equicom | PC Bond | Shorcan

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Richard's Excellent Portfolio

October 1992







Stock	Shares	Cost	Outlay
 PHILIP MORRIS INTERNATIONAL	177	\$ 28.25	\$ 5,000
 MERCK <i>Be well</i>	123	\$ 40.65	\$ 5,000
	112	\$ 44.64	\$ 5,000
	606	\$ 8.25	\$ 5,000
Total Portfolio			\$ 20,000



One Year Later!

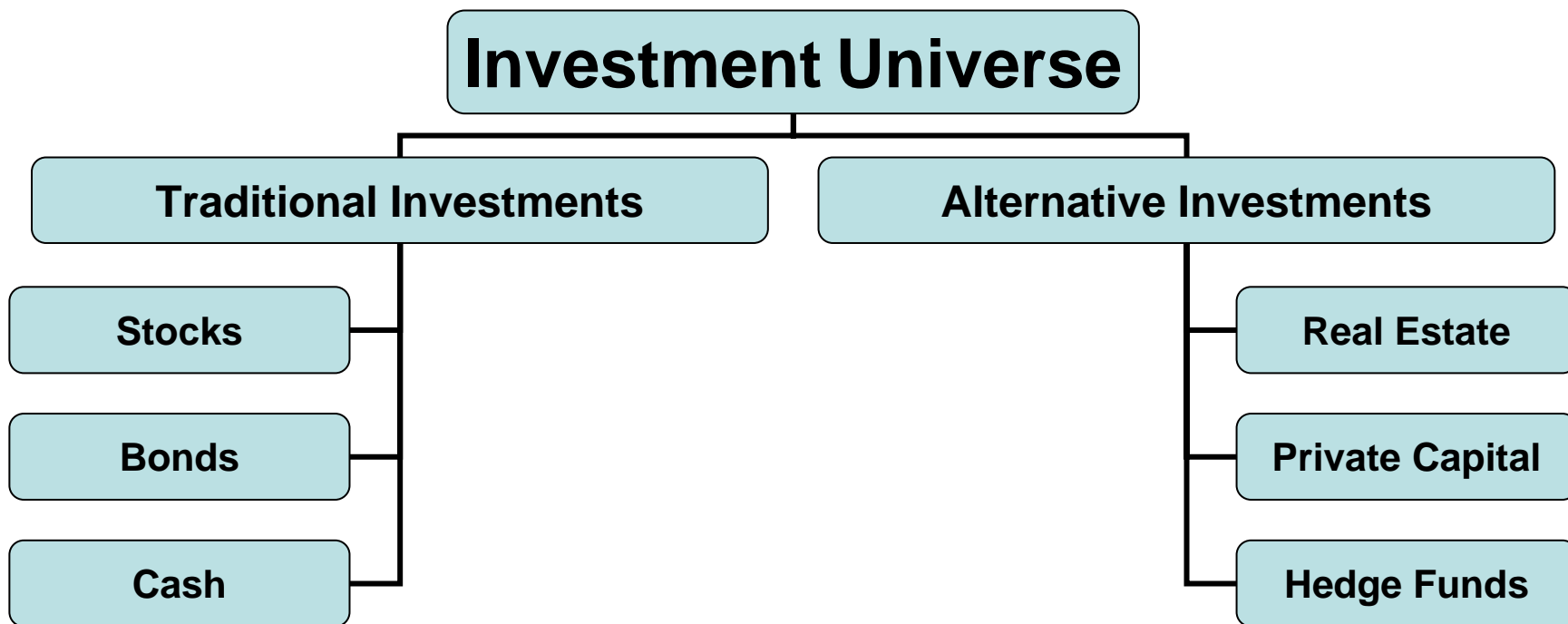
October 1993



Stock	Cost	Market	Value
 PHILIP MORRIS INTERNATIONAL	\$ 28.25	\$ 15.25	\$ 2,699
 MERCK <i>Be well</i>	\$ 40.50	\$ 23.00	\$ 2,829
	\$ 44.50	\$ 30.75	\$ 3,444
	\$ 8.25	\$ 20.00	\$ 12,120
Total Portfolio			\$ 21,092

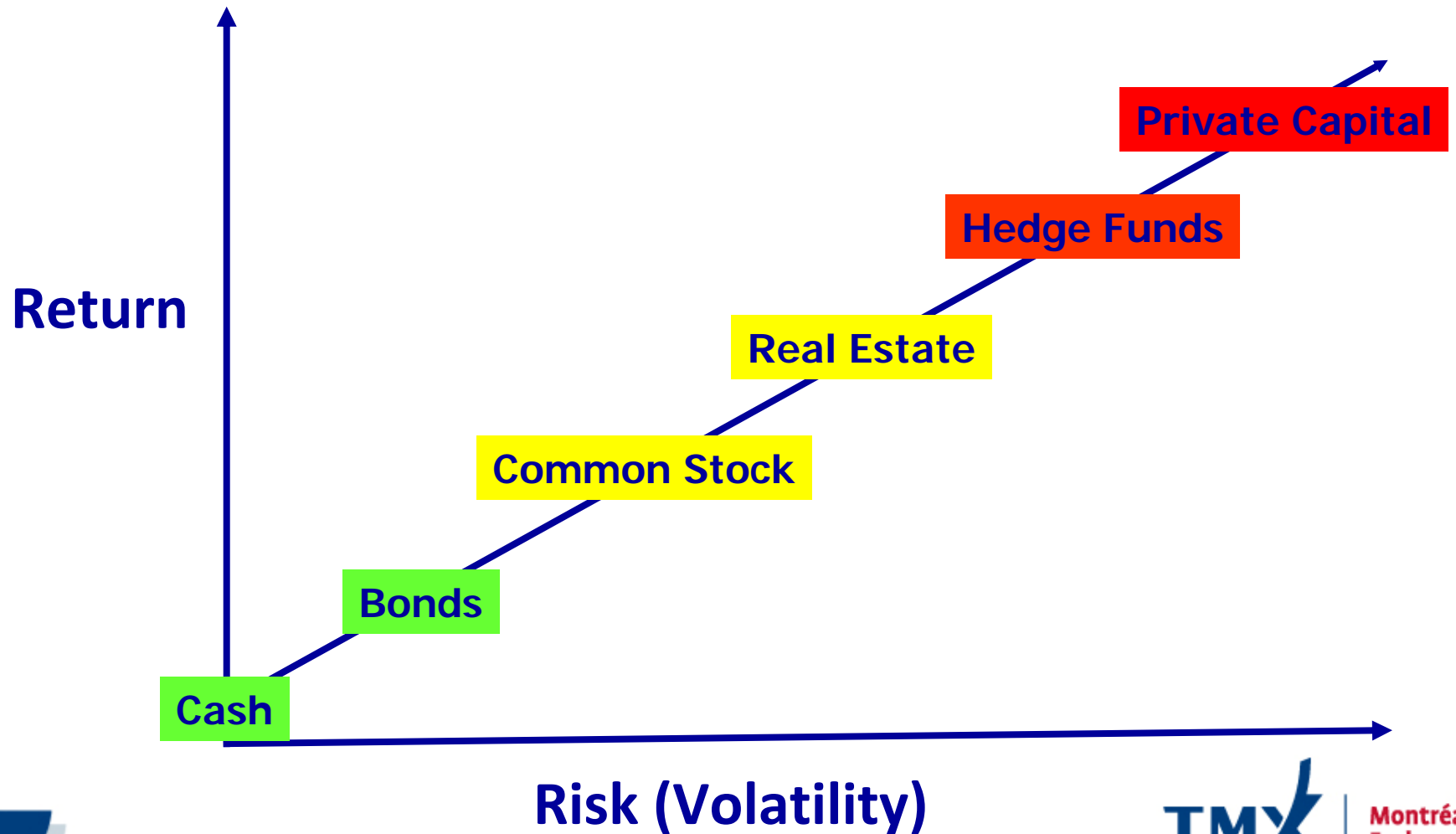


Today... Portfolios Are More Complicated



Today... we recognize trade-offs exist

Typically, a unit of return requires three units of risk



But... lower costs, more choices



● Exchange Traded Funds

- Passive broad based cap weighted indexes
- Sector ETFs, Commodity ETFs
- Leveraged ETFs

● Fundamental ETFs

- A better way to index?

● Alpha ETFs – competition to mutual funds?

- Active management
- Recognizable names



What Has Not Changed?

We still need to set up a plan



- Understand your objectives
- Recognize your limitations (risk profile)
 - Ability to withstand “black swan” events
- Establish an appropriate asset mix
 - Add levels of diversification
- Focus on the portfolio’s bottom line
- Measure performance



But That's Not Happening!



- Return expectations drive investment decisions.
 - With little or no thought about objectives or risk.
- Investors are focused on the short term.
 - Average fund holding period is 17 months
 - We are questioning the value of Buy and Hold.
- Unfortunately, normal human behavior doesn't help.
 - Too many decisions are driven by fear and greed.



Behavioral Traits



- Investors are not risk averse
 - Investors are loss averse
- Investors are reference dependent
 - Anchor theory and House money
- Problems with liquidity
 - Myopic loss aversion



Black Swan Events?



- Black Monday Oct 19th, 1987
- The rise of the internet
- The rise of the personal computer
- September 11, 2001 terrorist attacks
- Sub-prime crisis



Is Buy and Hold Dead?

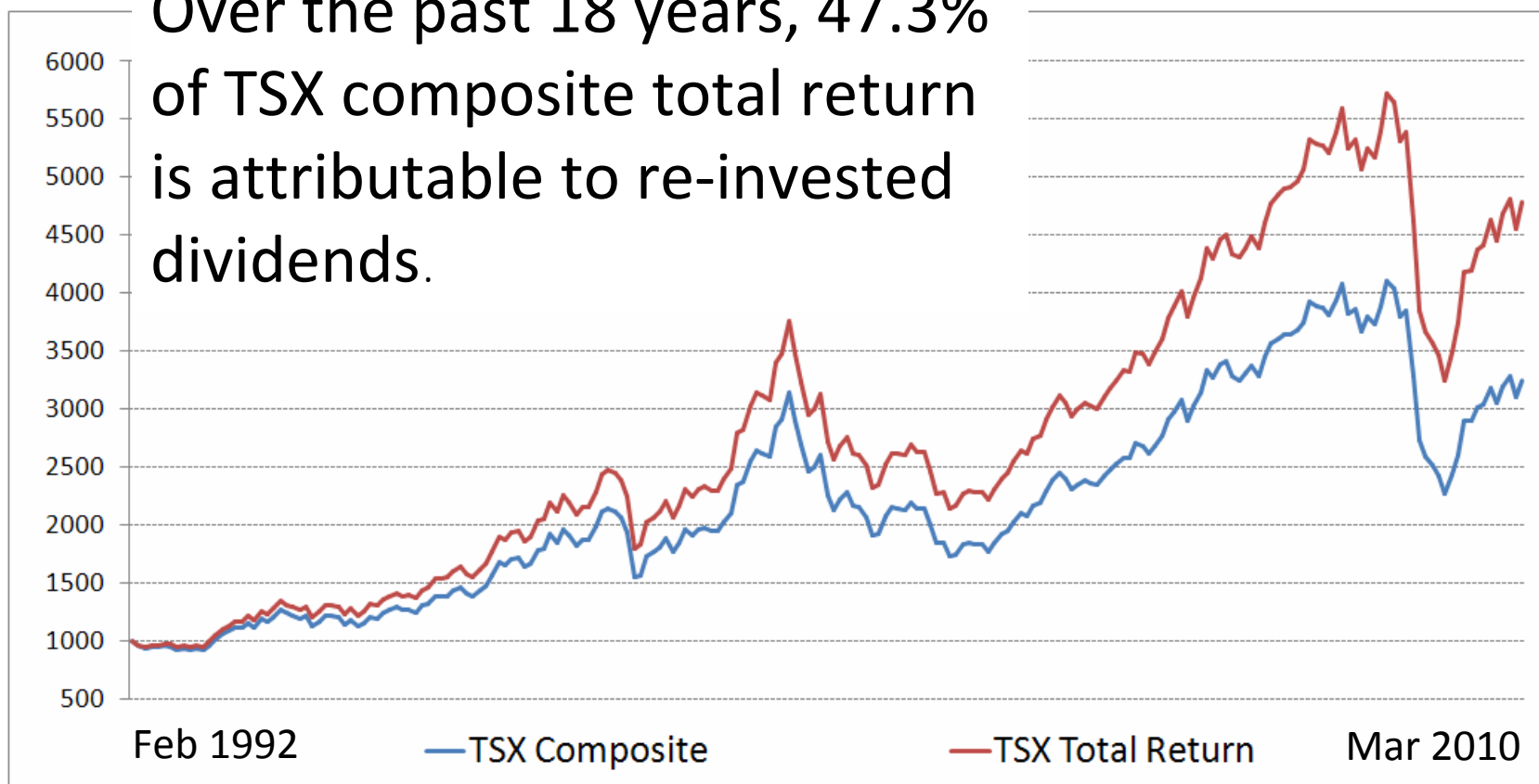


- Depends on your point of view.
- Are you seeking capital appreciation or total return?
 - Depending on your time frame, re-invested dividends can account for the majority of your total return.
- Are you willing to evaluate your financial objectives within the context of your risk tolerance?
 - That's critical if you are buying and holding



Long Term Value of Dividends!

Over the past 18 years, 47.3% of TSX composite total return is attributable to re-invested dividends.



Is There A Better Way?

Recognizing that investors will not likely change.

Portfolio management balances;

- The science of managing risk and return
- The art associated with experience and insight
- The reality of managing fear and greed.

Nowhere is the balance more evident than in the process of designing an investment strategy – whether in the steps taken to design an appropriate asset mix – or the considerations for tax efficiency and cost effective re-balancing.

A core / satellite strategy that explicitly combines active and passive investing is a powerful tool that investors can use to strike an appropriate balance between risk and return.

Source: www.ishares.ca

What Is A Core / Satellite Strategy

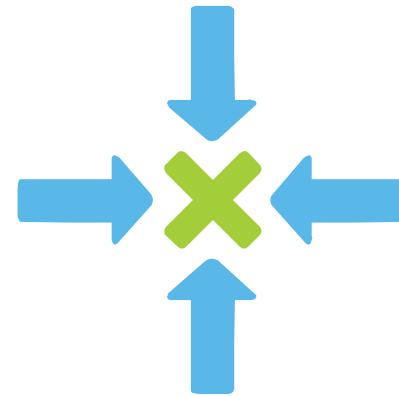


- A passive “beta” core foundation.
 - A portfolio of indexed assets
- Plus a satellite strategy in search of alpha.
 - Sector positioning
 - Covered option writing and hedge funds
 - Stock picking and day trading





THE CORE



Start At The Beginning...

What is a portfolio?



- A portfolio is a diversified intelligently - combined, collection of securities.
- Portfolios are constructed within the context of how well new securities fit with securities already there.
- The goal is to ascertain what the inclusion of an additional security will add to the portfolio in terms of return, and what it will do to the portfolio's risk.



How Do You Define Risk?



- Inflation risk
- Risk of outliving your capital
- Risk of not meeting financial goals
- Portfolio volatility

In reality, risk is the result of a disconnect between expectations and reality. Buying on the basis of return expectations does not take risk into account!



The Rationale For Diversification



Diversification reduces risk!

Proper diversification weighs the value of any security within a portfolio on the basis of its potential return metrics relative to its risk reduction characteristics.



Levels of Diversification



By Asset Mix

-  Cash, Income, Equities, Real Estate, Alternative Strategies

Geographic

-  Canada, US, EAFE, Emerging Markets

Size

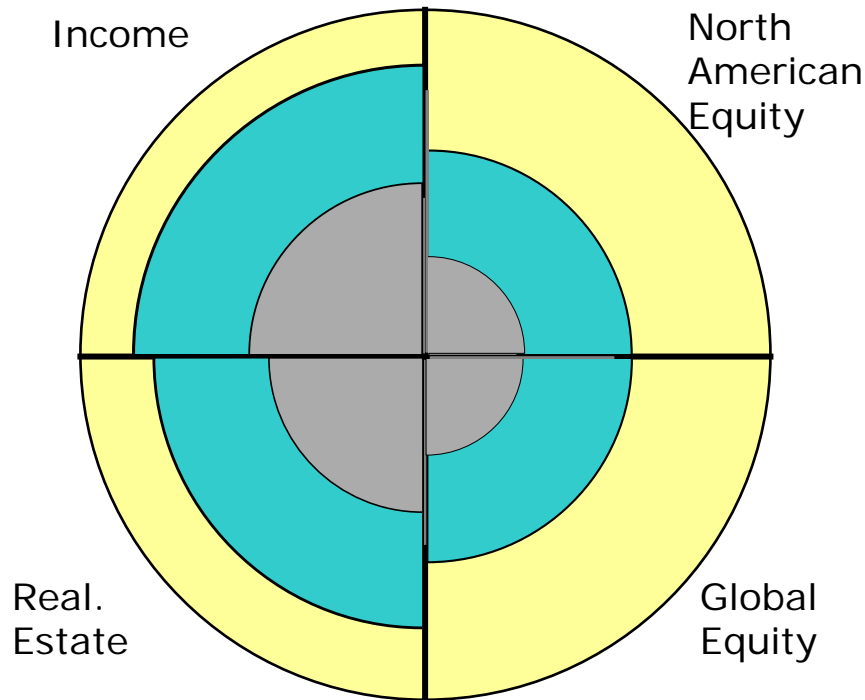
-  Large cap, Mid cap, Small cap and Micro cap




Style – passive (beta) and active (alpha)

-  Indexed, Value, Growth, Momentum



A Core / Satellite Approach



 Broad ETFs  Style ETFs
 Risk Management Overlay

Asset & Geographic Mix

-  Income Assets
Cash, Bonds, Preferreds
-  North American Equity
Canada, US
-  Global Equity
EAFE, Emerging Markets
-  Real Estate
REITs, Hard Assets



Core Portfolio – “Beta”



Securities

Claymore Premium Money Market ETF

Claymore 1-5 year Laddered Government Bond ETF

iShares Broad Bond Index Fund

iShares S&P / TSX Large Cap 60 Index Fund

iShares CND S&P 500 Hedged to CAD Index Fund

iShares CND MSCI EAFE Hedged to CAD Index Fund

Claymore Broad Emerging Markets ETF

Diversification

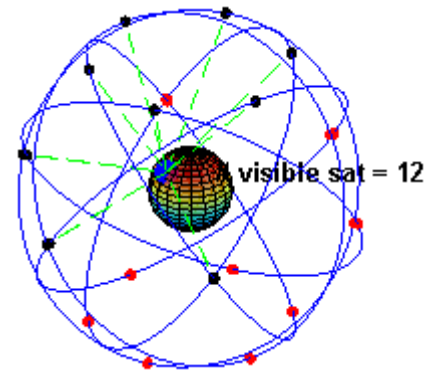
- Asset Mix
 - Cash
 - Fixed Income
 - Equity
- Geographic
 - North America
 - EAFE
 - Emerging Mkts
- Size
 - Large Cap
- Style
 - Passive Indexed





SATELITTE

Seeking Alpha!



Satellite Strategy - Seeking Alpha



- Typical strategies seek returns that beat their respective benchmark.
 - What style beats its benchmark?
 - Does value outperform growth?
 - What about day trading or hedge funds?
- The assumption is that markets are NOT efficient.
 - Short term that may be correct
 - Longer term, each style has its day in the sun.
- Generating alpha should be the objective.



What Is Alpha?



- Alpha is calculated by measuring the risk adjusted returns of a strategy relative to an appropriate benchmark . For example...
 - The strategy; covered call writing on an equity index
 - The benchmark; buy and hold on the underlying index
- Alpha results from;
 - Matching the benchmark performance with less risk
 - Beating the benchmark with the same or less risk
 - Significantly out-performing the benchmark by assuming additional risk (i.e. leverage)



Quantifying Risk



- Option pricing models provide a metric for measuring risk.
 - Mathematically, how much risk must be assumed for a given level of return.
- Measuring volatility is how we quantify risk.
 - Understanding volatility is as important to an options trader as earnings are to a securities analyst.



Option Pricing Models

Black-Scholes Formula

$$C(S, E, t, r, \sigma) = e^{-\delta t} S N(d_1) - E e^{-rt} N(d_2)$$

Where:

$$d_1 = [\ln(S/E) + (r - \delta + \sigma^2/2) t] / \sigma \sqrt{t}$$

$$d_2 = d_1 - \sigma \sqrt{t}$$



Impact Of Volatility



The Option Pricing Formula

Stock Price	100
Strike Price	100
Days to Expiration	178
Quarterly Dividend	0.25
Annual Interest Rate	3%
Volatility	15%

Call Price	\$	4.47	\$
Put Price	\$	3.86	\$



Implied Trading Range



The Option Pricing Formula

March 10-2009

iShares CDN S&P/TSX 60 Index Fund			\$	17.69
XIU March 2011	18.00	call		1.15
XIU March 2011	18.00	put		1.75

Implied Trading Range S&P / TSX Large Cap Fund

Upper Trading Band	18.00	+	2.90	=	20.90
Lower Trading Band	18.00	-	2.90	=	15.10

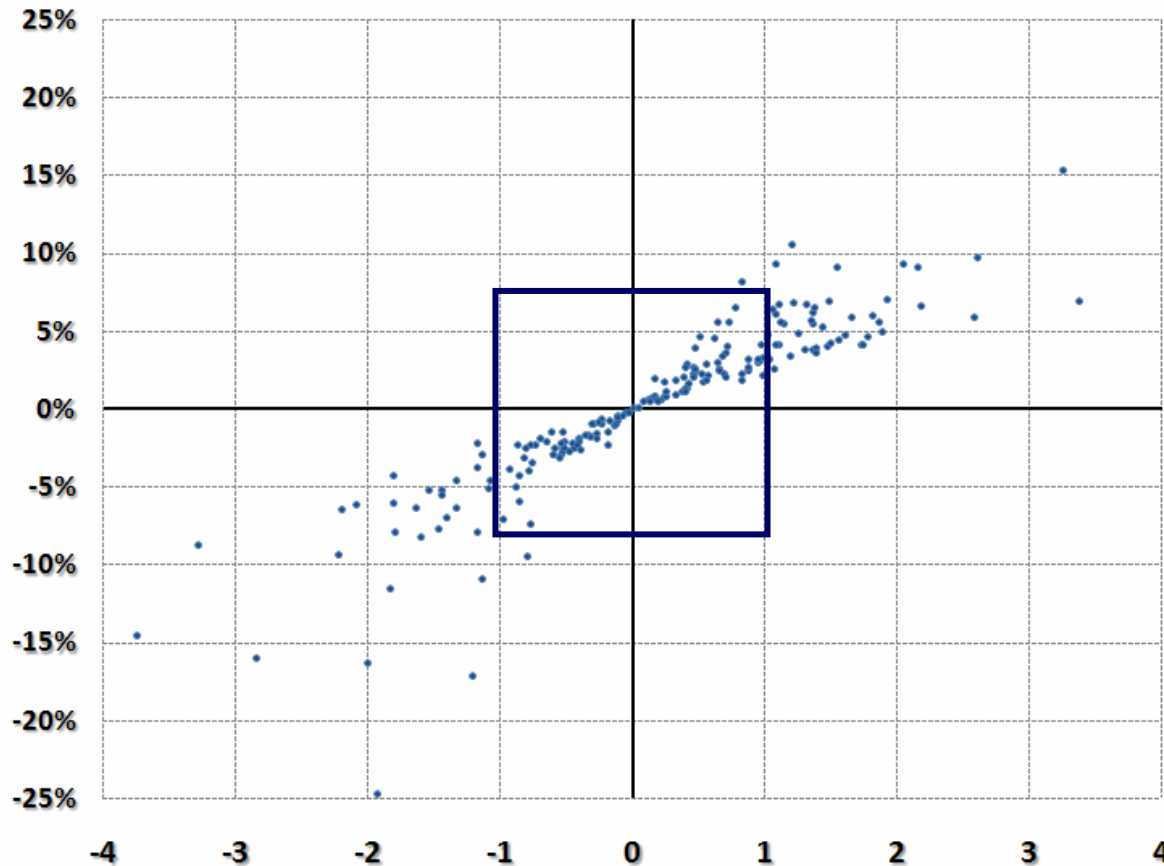
Implied Trading Range TSX Composite Index

Upper Trading Band	12,114	+	1,952	=	14,066
Lower Trading Band	12,114	-	1,952	=	10,162



Are Markets Really Efficient?

TSX Composite Index - Monthly Returns 1993 to 2010



Monthly option premium matched or exceeded the return of the underlying index 60.31% of the time based on 194 monthly data points from Feb 1993 to Feb 2010.



But...



Looking at shorter time horizons, the arguments are not as clear. Based on 3881 daily observations over the same period, the TSX composite index actually breached the trading range implied by the option market 67.59% of the time.

In essence this is telling us that in the majority of instances, there will be a point during a 30 day straddle where the buyer will be in a profitable position.



Let's Pretend...

Longer term, the stock market is efficient!



- That current market values reflect an unbiased view based on all known available information.
- Short term market fluctuations are random and unpredictable.
- Markets tend to overshoot up or down in the medium term.
- A stock's current value is the market's best guess as to its long term return potential.



The Options Market Is Efficient



- Current option values reflect an unbiased view based on all known available information.
- Options value risk, referred to as implied volatility.
- Short term fluctuations in volatility are random and unpredictable.
- An options price is the markets best guess at quantifying short and medium term risk.



Covered Call Writing

Buying into the concept of efficient markets



- Establish a price at which you are willing to sell the stock
- Reduce your risk (i.e. downside price) by the premium received
- Create tax advantaged cash flow
 - Premium is taxed as a capital gain
- A strategy that historically, has consistently generated alpha.



Covered Writing Generates Alpha!



Mx Covered Call Writers Index



Compound Return	
Option Writing:	8.50%
S&P TSX 60:	7.52%

Standard Deviation	
Option Writing:	13.05%
S&P TSX 60:	19.20%

MX Covered Option Writing Index



iShares Cdn Large Cap 60 Index Fund



A Covered Write Example



Implied Volatility: ~30%

Trade Date: March 11-2010

				<u>Units</u>	<u>Price</u>	<u>Totals</u>
Buy	Barrick Gold			1,000	40.00	40,000.00
Sell	ABX	Jan (2011)	40.00 calls	1,000	4.85	(4,850.00)
Per Share Dividend				0.10		
Number of Dividend Payments				4		

The Outcome as of January 2010

Share Price Above	\$ 40.00	15.11% *	16.08% **
Share price unchanged	\$ 40.00	15.11% *	16.08% **
Downside Break Even	\$ 34.75	13.13%	

* Actual Return over time period

** Annualized return



Three Out Of Four Ain't bad!



- Covered option writing outperforms if
 - Markets decline (you will lose less)
 - Markets are stable
 - Markets rise slightly
- The strategy underperforms if
 - Markets rise quickly and significantly





Questions

