



## **A new and improved Tortoise Strategy**

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As you probably know, I have been a big proponent of the Strong Funds family since the inception of the public Tortoise in 1998. I track and report on 9 fund families, but Strong has always been where my personal money and best attention have been. Many Tortoise members chose Strong to execute their trades for that reason, although many have done quite well in other families and by using a "best of breed" approach. Another group have been selectively applying the Tortoise to Exchange Traded Funds (ETFs) and done very well (more on that later).

Part of my affinity for Strong Funds comes from my close association with their funds over the years. When I bought my first mutual fund, 23 years ago, I was a private in the Army and they had 3 funds at the time. Over the years, I've watched them grow and have taken advantage of their excellent service and the ever increasing numbers of funds they have offered.

In the past year, however Strong has been selectively closing the windows of opportunity to Tortoise style fund timers (and other fund timers in general), particularly in the funds with less capitalization. From their perspective that's understandable. This week however, they have made a drastic policy decision to tighten up their standards on frequent fund traders that, in my opinion, closes our window of opportunity to use the Tortoise method in their funds. The SEC investigation into 4 mutual fund families for illegal trading and "market timing" by hedge funds has sent shock waves through the mutual fund industry. Strong is particularly in the spotlight as one of the 4 fund families directly involved. Although the "market timing" in question is not of the same nature of the Tortoise method, it clearly has prompted Strong (and many other families) to scrutinize much more closely the trading patterns of their clients. Not surprisingly, a number of our members have been contacted this week by Strong representatives and informed that they no longer wanted our business, myself included

**Problem:** Strong Funds, and by extension most other fund families, will no longer support direct fund timing activities

**Promise:** I believe we have at least 3 excellent alternatives to be able to use the Tortoise method and achieve similar or better results than we have experienced, which I will outline below. The Tortoise

methodology is sound and can still be implemented, but in a different set of trading vehicles at deep discount brokers.

Proposal: I want to keep you as a satisfied Tortoise member and want to continue to provide you the decision support tools you want and have come to rely on. I have been using the following strategies I outline below with real personal money just in case we ever found ourselves in the current situation. I am confident in these strategies because they are a natural extension and application of our proven Tortoise strategy.

**Strategy 1:** Best of Breed Mutual Funds at a Deep Discount Broker: establish your account at a deep discount broker like Etrade or Scott trade, and take advantage of the hundreds of no load, no transaction fee funds they offer, and get good customer service, an Internet trading platform, and an extra layer of insulation between our trading activity and the mutual funds themselves. I have already loaded up a new database with 1775 no load/no transaction fee (NL/NTF) mutual funds that are available at Etrade and ScottTrade, categorized by their Morningstar mutual fund style box (Large Cap Value, Blend, Growth; Mid cap Value, Blend Growth, and Small Cap Value Blend and Growth). I will be performing style box analysis of these 1775 funds and comparing each of the 9 styles to the performance of the S&P 500 Index to identify those pockets of strength where our money is best deployed. I have been doing this same analysis for years, and have been including it in the weekly email and Category Report. It is a reliable method of finding strength. I will make recommendations for allocating capital into each of those style boxes. Within each of the style boxes, I will identify those funds beating the S&P 500 on a 1wk, 3wk, 5wk % basis, and rank them by performance. I will identify which of the deep discount brokers offer them for sale, and provide a quicklink to Yahoo finance charts for those who want to study them in greater detail.

#### Advantages:

- (1) We will get hundreds of choices in each style box and stand a much better chance of finding the truly exceptional funds, as compared to limiting ourselves to a single fund family.
- (2) We will have access to specialty funds that Strong and other families may not have had. For example: a variety of Real Estate Investment Trust funds, Precious Metals, a variety of Asian and Latin America focus funds have done extremely well this year, but we could not take advantage of those all in a single fund family
- (3) For folks managing funds within a company retirement plan that don't have access to ETFs, for example, you will still be able to make the best choices among your options.
- (4) For folks with smaller accounts it may not make sense to absorb the brokerage trading costs of ETFs, and funds may be a better tradeoff on the cost basis

#### Disadvantages:

(1) Deep discount brokers may offer an extra layer of insulation, but it remains a real possibility that individual fund families may prohibit frequent trading by specific people. In this event the effect is only that you could not make a purchase you wanted to make. Sales must still be honored, so your risk is only some opportunity cost for a purchase not made. This disadvantage is offset by the fact that there will be many acceptable choices within each style box and so we will be able to find reasonable funds with little difficulty in my estimation.

Notes: I am personally choosing Scott Trade for this strategy since they offer many more funds than ETrade, have a great reputation for customer service, many local offices across the country, and offer a \$7 commission on stock and ETF purchases, which matters to me since I do both of those activities as well. They do assess a \$17 dollar fee for funds held less than 90 days, whereas ETrade does not have that fee. Etrade also will refund 50% of any assessed 12-b charges, the only brokerage to do that. Neither brokerage puts any limitations on frequent trading of funds, which remains a prerogative of the individual funds as noted above. Either brokerage in my opinion is acceptable. I am also open to studying other brokerages if members have had good experiences with others and will add funds from such brokers as they are identified.

#### **Strategy 2:** Tortoise Method applied to index-matching Exchange Traded

Funds: After applying the Morningstar style box analysis to the 1775 funds noted above, I will identify those style boxes that are outperforming the S&P 500 and make recommendations for asset allocation amongst the style boxes. There are Exchange traded funds that match the broad indices upon which the style boxes are based. These broad index matching funds cross over many different market sectors and hundreds of individual companies and so offer the same degree of diversification as actively managed conventional mutual funds. In this strategy I will not be recommending narrowly defined sector funds like biotechnology (BBH) or semiconductors (SMH), since those sector funds in my experience are too volatile to employ in a once a week strategy. The good news is that there are more than one choice of these broad index matching ETFs in every Morningstar style box to choose from. The performance of these funds are consistent with the equity curves of actively managed funds in the same sector.

#### Advantages:

- (1) Simplicity: about 20 ETFs give us coverage of the world markets and indices
- (2) Broad index matching ETFs are relatively liquid and offer smooth equity curves.
- (3) ETFs are tax efficient and offer the ability to set explicit stop loss limits that can be executed during the trading day as an extra measure of protection

Disadvantages:

- (1) Commissions for buying and selling, which will vary between brokers
- (2) Intraday slippage, but which is offset by the ability to trade during the day, if desired.

Notes: The \$7 Scott Trade commission compares favorably with their \$17 fee for funds held less than 90 days. Etrade's rates are a bit higher. StrongOne brokerage is not competitive, as I have had slippage issues and their commissions are too high at 14.95-24.95 depending on size and ETF

Strategy 3: Tortoise Method applied to Exchange Traded Funds, including specialty and country ETFs: same as Strategy 2 but I will also identify specific country funds and specialty sector ETFs which I believe offer opportunities with attractive risk/reward features. These will include country ETFs like EWJ (Japan), EWZ (Brazil), EEM (Emerging Markets), RWR (REIT Index) and the Gold ETF when it is activated. Same Advantages and Disadvantages as noted above with the following additions:

Advantages:

- (1) Wider range of targets, offering advantages when currencies are involved
- (2) Many of the country ETFs are very liquid and broadly diversified (like EWJ: Japan)

Disadvantages:

(1) some of the country funds are not very liquid, and have a wider bid/ask spread than the more liquid ETFs. This can be offset by smaller position size

**Strategy 4:** Tortoise Method applied to Exchange Traded Funds, including specialty and country ETFs, including selected large cap stocks that take advantage of sector strength better than ETFs: 3 good examples that come to mind in the current market are:

- (1) HOV (the strongest homebuilder in one of the top 2 or 3 sectors)
- (2) NEM (the largest unhedged gold miner, which can act as a proxy for the gold sector until the gold ETF is activated)

(3) PD ( a basic materials metals miner which is strong when commodities are strong, like right now, and which is outperforming NEM)

Advantages:

(1) Wider range of targets, offering advantages when currencies are involved

Disadvantages:

(1)additional time and judgement required

**Strategy 5:** A mix of mutual funds, supplemented by ETFs and selected stocks. As you can see this would be the most comprehensive one of all, and would/could include the use of a bear mutual fund to hedge the downside when the Tortoise model calls for us to go to cash. The best fund I know for bear markets is BEARX, which is offered at both ETrade and ScottTrade. I personally use a "1/3 of cash position" rule for BEARX and have been satisfied. For example: when the Tortoise model calls for 75% cash, I will initiate a 25% position in BEARX .

Notes:

1. I believe the strategies I have laid out above are reasonable, and consistent with the proven Tortoise strategy.
2. I have used real money on all of these strategies and have achieved acceptable results that match or exceed the Tortoise performance this year.
3. I want to keep you as a satisfied Tortoise member and want to continue to provide you the decision support tools you want and have come to rely on.
4. I am preparing notes for a once a month and once a year adjustment strategy for folks looking to reduce time and activity commitments (with the associated performance implications however)
5. If you decide the strategies above just don't fit for you, I will do my best to help guide you in other directions that WILL fit you. I believe I owe you a duty in that regard based on your trust and commitment to me as a Tortoise member
6. A note for billing in October. Our billing cycle covers the

previous 30 days of service. I recognize however that a transition to a new broker takes time. I propose to bill in October at a  $\frac{3}{4}$  rate to cover the previous 3 weeks , and then resume billing once you are established with a new brokerage

7. As part of my next presentation at IITM in November I will be producing another whitepaper and slides that discusses the strategies above. I'll be packaging those briefings and some useful trading tools on a disk that I'll be selling from the website. You will get a copy of the files and briefings and papers as a gift, no matter what, as my way of saying thanks for your support.

8. Given the nature of the extra work and value I perceive in these strategies, I will probably be raising the subscription rates for new members. As existing Tortoise members however, you are entitled to your current rates for life. Again, thanks for your support

This is plenty long already, so let me close and get this to you so you can digest it. I think I have covered the main issues. The initial reports for the new strategies I will have prototyped and in your hands this weekend, so we can adjust formats to what works best for you. I will continue to produce the specific funds family reports in current formats as well, probably through the end of the year for consistency and completeness. To track the performance of the theoretical model I will continue to monitor the Strong funds theoretical performance. At the start of the year I will be tracking theoretical performance of the new strategies in some manner.

Please let me know your questions and comments,

Cheers!

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