

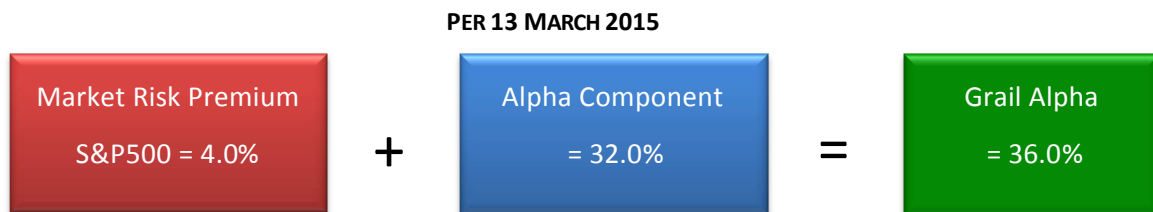


I wrote on 25 February with the title 'THE GRAIL ANOMALY', referencing a joint-paper by Professor Malcom Baker of Harvard University and Messrs. Bradly and Wurgler, entitled 'BENCHMARKS TO LIMITS TO ARBITRAGE: UNDERSTANDING THE LOW VOLATILITY ANOMALY'. Their research paper covered 41 years of data and provided conclusive evidence that **Low Risk equals High Returns!**

Here I summarize the essence of my findings in the Grail Alpha Portfolio (GAP), which confirms the hypothesis that **Low Volatility does equal High Returns**. This is in contrast to the conventional wisdom that only **High Risk equals High Returns**. As you are truly aware, this has given rise to a high concentration of almost indistinguishable Index Funds with, if any, only the smallest addition of Alpha or stock-specific attributes, perhaps just sufficient to marginally outperform the Market Risk Premium of a surrogate index. Here is a fund per 13 March 2015 with a year-to-date performance of **-0.35%**, i.e. with no positive alpha component:



On the other hand, the GAP has a very strong stock-specific or Alpha return of 32.0%, the net of which surpasses by far that of an index-driven portfolio. The key is to select companies with sustainable competitive advantages, catalytic momentum and consistency of performance, which endow such stocks with a far greater certainty of growth.



This table gives the average earnings projections of GAP's 36 stocks and the metrics that accompany them:

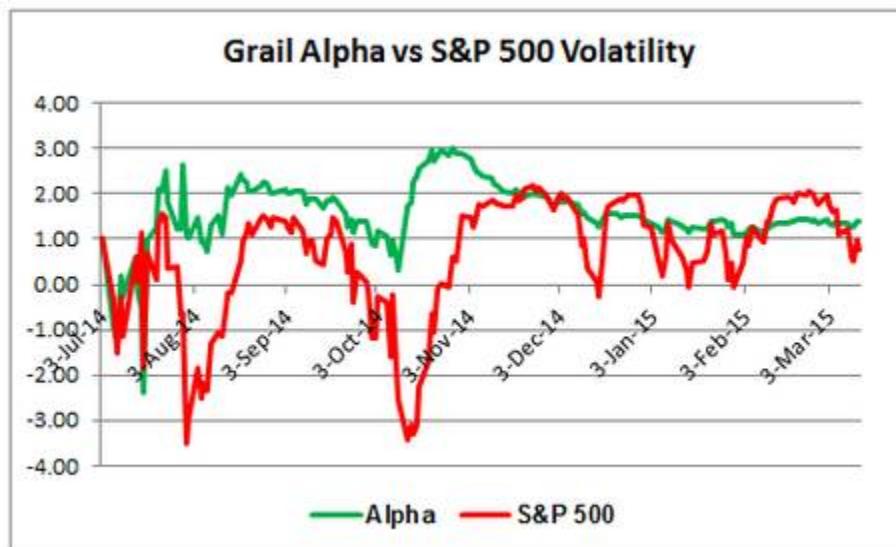
| | EPS Growth Q1 | EPS Growth Q2 | EPS Average Growth | P/E Ratio | PEG | Beta |
|-----------------|---------------|---------------|--------------------|-----------|-------------|-------------|
| Averages | 94% | 35% | 64% | 18 | 1.07 | 0.98 |

| Risk Metrics per 13 March 2015 | | | | | |
|--------------------------------|------|-----------------------|-------------|-------------------------------|------------|
| | Beta | Value at Risk (sigma) | Correlation | Grail Margin of Safety Ratio+ | R-Squared* |
| S&P 500 | 1.00 | 0.75 | | 1.09 | 1.00 |
| Grail Alpha Portfolio | 0.98 | 1.33 | | 1.96 | -0.222 |
| Grail Alpha/S&P 500 | | | 0.41 | | |

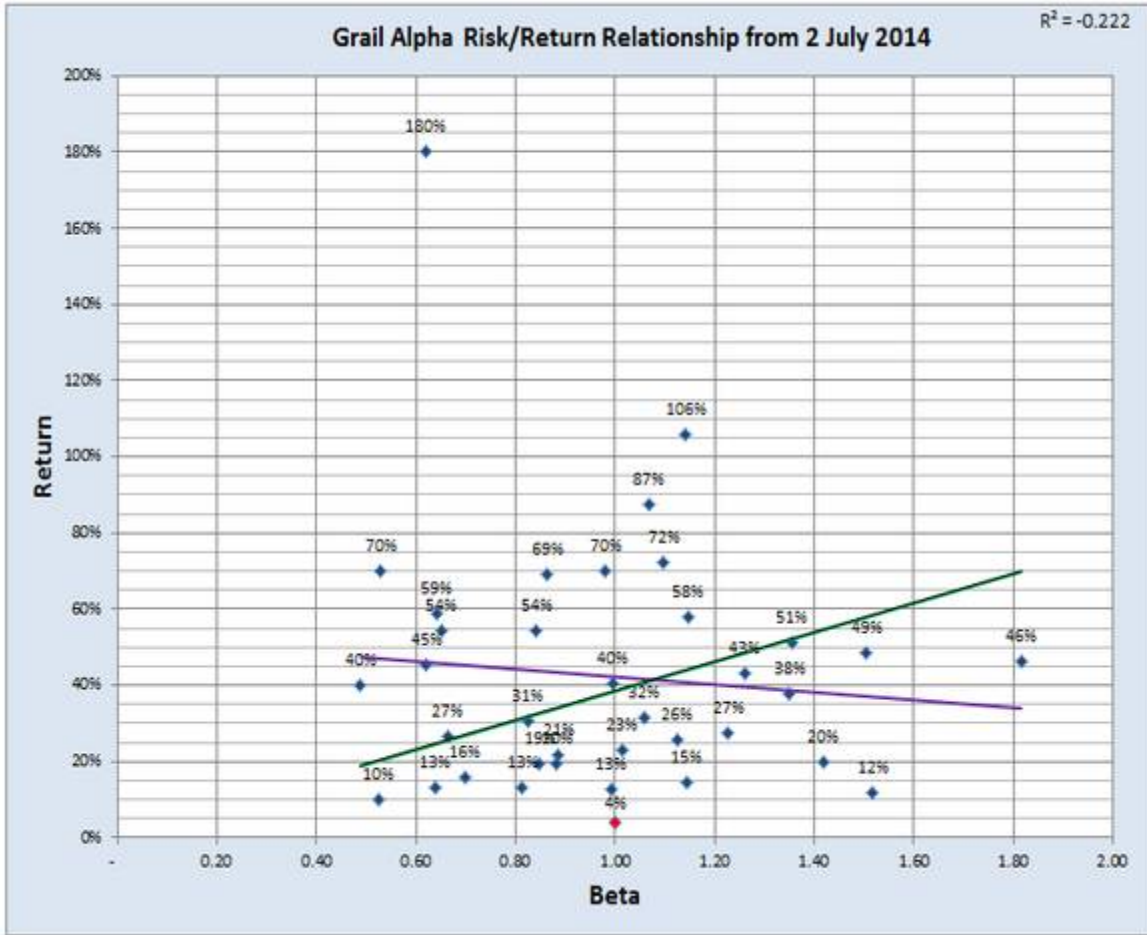
+ Propriety Indicator

* An R-Squared value of 1.00 means that all movements of a security are completely explained by the movements in the index. A security with a low R-Value of 0.70 or less does not behave much like the index (S&P500)

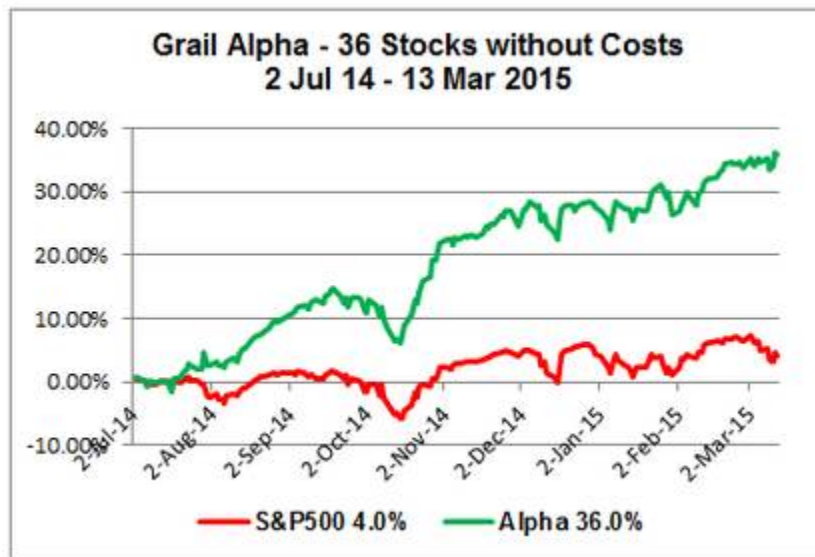
This graph tracks both the GAP and the S&P volatility on a daily Value at Risk basis per Friday 13 March 2015, clearly showing that the S&P 500 has greater volatility than GAP.



One of the issues that Baker et al made clear was that conventional investors mistakenly believe that subscribing to an Index Fund is safer, when it may be riskier. For GAP, this is not the case, since its margin of safety is high although its Beta is only 0.98. As per Friday, 13 March 2015, the S&P 500 dropped to a negative year-to-date return of -0.3% and from 2 July 2014 is only +4.0%, thus possessing a small margin of safety, as the red marker on the scatter graph shows:



GAP'S DAILY PERFORMANCE



Paradoxically, this proves that investors are misguided, perhaps innocently, about the risk properties of funds and portfolios, as the current performance of U.S. equity index funds are offering **HIGHER RISKS WITH LOW TO NEGATIVE RETURNS**, based on the false premise that the removal of non-systematic

component offers a safer, but lower return. However, as a stock's price and its risk are inseparably the same, the process of diversification is nothing more mystifying than the average return of a portfolio's constituent prices, which can be separated into systematic and unsystematic elements. The Market Asset Pricing Model (CAPM) calculates only the market risk premium, on which index-related funds are based, in spite of the fact that through diligent selection processes, positive Alpha returns, such as found in GAP, can be very high.

It is comforting to have the reassurance of Baker et al's paper confirming the Grail Equity Management System's (GEMS) **low risk, high return** model is a forerunner of their revelations, but it is also saddening, don't you think, that the vast majority of investors are denied the opportunities that Baker et al's ground-breaking research reveals by the propagation of correct, but incomplete, notions about risk.

Finally I would like to join with Professor Baker and Co. in the sentiment they expressed:

“We believe the long-term outperformance of low risk portfolios is perhaps the greatest anomaly in finance. It is large in economic magnitude and practical relevance and challenges the basic notion of a risk-return trade off.”

John Henry Smith