Investment Policy Statement
Leveraged Equity Index Strategy

by Smart Capital Management Ltd.

THE PURPOSE OF ESTABLISHING INVESTMENT POLICY STATEMENT

A keystone of the investment process is the Investment Policy Statement (IPS). A tool used by billion-dollar institutional fund managers, an IPS is a vital component to our mission of helping you plan, build, and preserve your wealth.

An Investment Policy Statement documents specific, long-term portfolio goals and parameters. These include risk tolerance, return goals, investment timeline, tax picture, investment constraints, and other specific considerations. This helps carry an appropriate amount of investment risk that matches our investment goals. To ensure IPS remains a working document, we update it annually and/or any time there is a major change in circumstances.

The principal reason for explicitly articulating and writing a long-term investment policy is to protect the portfolio from emotional and arbitrary revisions of sound long-term policy. This written investment policy statement will help maintain our long-term focus when short-term market movements may be distressing, and the policy guidelines are being sorely tested.

The very process of creating an investment policy statement embodies the essence of financial planning: assessing current financial situation, setting goals, developing a strategy to meet the goals, implementing the strategy and regularly reviewing the results. By linking goals to the investment strategy necessary to achieve them, we create useful investment guidelines and reasonable expectations of portfolio performance.

Although we, acting as an Investment Manager, control the process and can capably and efficiently handle implementation, ongoing management and general portfolio operations, you must always shoulder the responsibility of determining your own overall investment policy and personal unique circumstances.

INVESTMENT PERIOD

It is considered good practice that the expected minimum investment period for any securities portfolio containing equities is five years. Otherwise, the portfolio's assets should be invested primarily in fixed-income securities. We view all variable return investments, including stocks, as long-term. Keep in mind, that by lengthening the investment period, the investment portfolio volatility is greatly reduced.

We established the investment period for this portfolio is over 10+ years (long term), to coincide with the overall goals of the strategy. Should you require the funds in the portfolio prior to this time, please recognize that you would likely be exposed to a higher loss at the time of early withdrawal.

RISK TOLERANCE

We view risk tolerance as the risk level that would cause you serious discomfort or concern. “Risk,” in this context, is defined in terms of the maximum loss you could absorb without abandoning your investment program (as defined by this investment policy statement).

In this context, taking into account return objectives, asset allocation choices, time horizon, leverage, and other important aspects of the investment strategy you should reasonably expect that the possible loss of the portfolio may exceed 50% or more at any particular point in time.

RETURN OBJECTIVES

The expected return of the portfolio is 10-15% per annum, on average over a long-time horizon - 10 years and more. Though, no guarantee can be made that these investment objectives can be met or that your investment will not have incurred a loss at the time of withdrawal.

The portfolio will be managed to minimize principal fluctuations, consistent with the stated return objectives. Using the precepts as described in this statement, we attempt to generate the desired rate of return at the minimum level of risk. The stated return objectives provide our best estimates of the portfolio’s future performance. This information is based on historical returns for these asset classes and an educated estimate of their future performance. Specifically, we compute and identify a range of possible returns for the entire portfolio over one, two, three, four, and five years. You should note that the returns at the lowest part of the range may be negative over an extended period of time and exceed levels of 50% of loss of value. At the “90% certainty level,” your returns should not fall below these estimates; they are, however, only estimates—reflections of our best, educated assumptions.

INVESTMENT STRATEGY

The assets of the portfolio will be invested in broad (country, region level) equity indexes with up to 50% leverage (mainly using futures and/or options on equity indexes). Up to 10% of the funds may be allocated to exploit tactical opportunities in the market such as investments in commodity baskets, fixed income, REITs, structured products and CISs, equity sector/factor ETFs and others.

The investment strategy is designed for growth, with the aim to beat the broad equity market over the long term. It is for investors who are comfortable with stock market risk and who seek higher returns than the broad equity market. These investors recognize that in order to build wealth over time they must invest in assets that potentially can, in unfavorable markets, show a capital loss over significant time periods—two to five years.

The main focus of the strategy will be on the overall composition of the portfolio rather than the traditional method of analyzing and evaluating the individual components, such as specific stock selection.

In general, asset allocation methods of the portfolio will have as their foundation four basic premises:

1. Investors are inherently risk averse. Investors should be unwilling to accept risk except where the level of returns generated will fairly compensate for that risk. In our experience, more investors call for reassurance when investments go down in value than when the market is going up. In other words, volatility doesn't bother them—only volatility involving a loss. Therefore, it is reasonable to assume that investors are more concerned with the risk of losing their capital than they are with returns on their capital.
2. Markets are essentially efficient. Most academic and industry research supports the idea that markets, at least in the broadest sense, are efficient. The nature of an efficient market is such that all participants have the same information regarding the market in general and specific issues in particular, at the same time. Often, however, they come to opposite conclusions as to the appropriate price of individual securities.
3. Shifting focus from individual securities analysis to consideration of portfolios as a whole, predicated on explicit risk-reward parameters and on the identification and quantification of portfolio objectives. Along with other academic work, a study by Merrill Lynch in 1979 showed that in a typical diversified investment portfolio, diversification eliminates so much of the "specific risk" (the risk that a specific company's stock will decline in value) that roughly 90% of all the risk in the portfolio is reduced to "market" risk (the irreducible risk of being "in the market") and only 5-10% is a specific risk. In another study, three leading financial analysts found that, on average, nearly 94% of the variability of a portfolio's return can be explained by the asset allocation policy followed—not the manager's timing or security selection.
4. Creating an "optimal" portfolio will generate the highest return for a given level of risk. In other words, for any level of risk an investor chooses to take, there is an optimal rate of return that should be achieved. Quantitative methods are used for measuring risk and diversification, making it possible to create efficient and theoretically optimal portfolios. Portfolio diversification is not so much a function of how many assets are involved as it is a function of the relationship of each asset to the other assets, and the proportionality of those assets to the overall portfolio.

The current portfolio strategy should be now viewed as a comprehensive all-around portfolio for a particular investor. Instead, it should only be considered as a possible complementary part to the overall portfolio of the investor.

PORTFOLIO REVIEW

Each quarter the portfolio is reviewed to ensure compliance with the IPS and to confirm the best available investment vehicles are being used to achieve your objectives. If this review determines the portfolio exceeds the risk tolerance or does not meet the return requirements, transactions are implemented in accordance with this Investment Policy Statement. The asset constraints section of the IPS provides the guidelines we need to ensure that these transactions are in compliance with the investment goals.

COMMISSIONS AND FEES

The fixed management fee is equal to 1% and is charged on a quarterly basis. The management fee is calculated as 1% times the net asset value of the portfolio as of the end of each month of the corresponding quarter. Net asset value is net of all taxes (if any), brokerage, custody, and other third-party fees.

The success fee is performance-based and equal to 10%. The success fee is applied on a quarterly basis and equals 10% multiplied by the net quarterly growth of the portfolio. Net growth of the portfolio is defined as the net positive change of the portfolio for the quarter net of all taxes, brokerage, custody, and management fees. A high-water mark provision is applied. A high-water mark is a minimum level that a fund manager needs to achieve to receive a performance bonus. It is used as a threshold to determine whether an investment manager can gain a performance fee. Investors benefit from a high-water mark by avoiding paying performance-based bonuses for poor performance or for the same performance twice.