Background

Whether an investor is seeking to make investments for themselves or a client, equities will always represent a major portion of the resulting portfolio. Therefore, the investor's skill in the art of selection companies can be the difference between poor or superior returns. Why an investor picks a particular equity is based on both a quantitative and qualitative assessment of the underlying company, the market in which it operates, and the overall market sentiment.

While most professional investors have developed proprietary "investment models", a number of standard models have evolved. One of the oldest is Value Investing, first described by Benjamin Graham and David Dodd in their 1934 book *Security Analysis*. They defined Value Investing as the identification of companies where there is a material difference between their market value and the intrinsic value of the business.

A company's share price (and market value) is easy to obtain, but calculating the intrinsic value of the business requires the ability to access and analyse historical financial data, trends and ratios. These are then used to project the company's future incomes. In essence, the intrinsic value of a business is the present day value of its projected financial performance.

Today Warren Buffett is regarded as the world's foremost proponent of Value Investing and, since 1965, his investment vehicle Berkshire Hathaway has delivered a compound growth rate of 19.8% per year; he must have got something right!

In 2001, Warren Buffet published his investment criteria, summarised below:

1. At least $50 million of pre-tax earnings
2. Ability to deliver consistent earning power
3. Good returns on equity, while employing little or no debt
4. An offer price
5. A good management team
6. A simple business model – an easy to understand value proposition

The last two of his criteria are qualitative, and there is no substitute for a sound assessment of a company under these and other headings. Rising Sum's role is to provide investors with a platform that uses the principles of Value Investing to calculate a company's intrinsic value and apply the tests as outlined by Buffet's additional four qualitative criteria. Rising Sum can apply this model to thousands of companies in real time, identifying companies where there is a material gap between their market and intrinsic value. And with a large number of listed companies, regular financial updates and share price movements, the picture can change daily.

We've also pioneered a new method to screen for companies with consistent Returns on Equity and Earnings Power (Net Profit Margin), called Alpha Slopes. You can find out more about this method on our website.

Example

As part of the Rising Sum proposition, we select stocks using our platform and create model portfolios. On 22nd August 2012 we ran the model and screened the UK All-Share index for equities with a high margin of safety (significant gap between intrinsic and market value).

We selected six equities and created a portfolio. As you can see from the following chart, our portfolio has outperformed the market, by almost 100%, in less than six months.

Company Name	**Allocation**	**Entry price 22 Aug 2012**	**Symbol**	**EOD Price (close) 18 Jan 2013**	**% change**
DIPLOMA	**20%**	4.25	DPLM.L	5.395	26.9%
VICTREX	**21%**	13.47	VCT.L	15.86	17.7%
SPIRAX SARCO	**10%**	19.54	SPX.L	22.77	16.5%
BURBERRY GROUP	**19%**	13.63	BRBY.L	13.86	1.7%
SAGE GROUP	**20%**	2.96	SGE.L	3.173	7.1%
HALMA	**10%**	4.15	HLMA.L	4.56	9.9%
				Rising Sum portfolio	13.44%
				UK All-Share Index	7.56%

To explain in more detail how the platform works, the following is a screen shot of one of the companies in our portfolio (Figure 1 VCT 22 Aug 2012). We have picked Victrex, a producer of polymer based materials, that are lighter and quicker to manufacture than their metal alternatives.

When an investor runs the screener, they can use a range of user-selected filters to create a target list. Once the target is identified the following data and charts are made available.

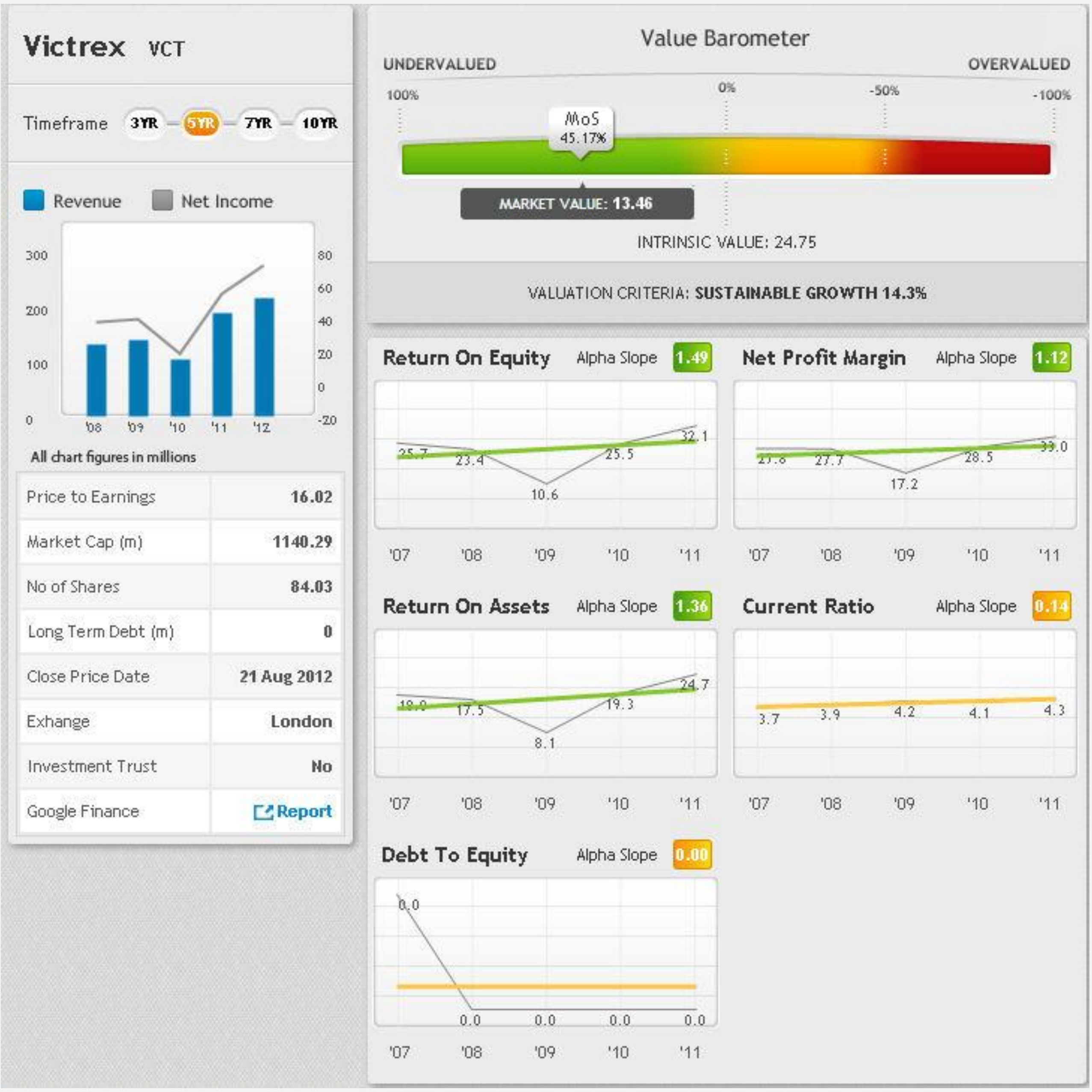

Figure 1 VCT 22 Aug 2012

As you can see from the screenshot, the value investment calculation computed the intrinsic value of the company and used this data and calculated a potential share price of 24.75. Based on a share-price of 13.47 (22 Aug 2012) the gap between the current price and the intrinsic value was greater than 45%, a high Margin of Safety. The supporting charts also demonstrate that the company's other key ratios were in line with Buffet's criteria.

The intrinsic value was based on an extrapolation of the last 5 years' financial data. The calculation could have used a different period – the investor can apply their judgment.

Summary

Rising Sum is a technology-based business. We are not telling investors which equities or markets to invest in, nor are we trying to make value judgements or present a qualitative assessment about a particular company. What we do is provide investors with a set of tools, which use tried and tested quantitative analytics to identify companies with the best potential. As Buffett proved with his investments and subsequent gains in IBM and Lubrizol, both identified in our model before he bought into them, companies of all sizes can be undervalued; the trick is to identify them.

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Notes

Rising Sum uses standardised pricing in pounds and pence, and dollars and cents. The LSE exchange publish prices UK stock prices in pence.