

A Letter from the President

January 7, 2009

Thank you for showing interest in my company. I have decided to provide a question and answer session to give a little background about my self and my company.

First of all I would like you to know that I have literally invested the last 12 years of my life in the defined risk strategy (“the Strategy”). Knowing this process would take a long time to perfect and learn, I have been careful not to grow my business too fast, which may have limited my ability to provide the best possible investment advisory services to my clients. You will get the same benefit my existing clients enjoy and you will enjoy the peace of mind gained from my knowledge and experience.

Since 2005, I debated whether or not to grow my business. During 2008, I made the decision to expand. To that end, I have added to the Swan Consulting team. I have added two people that I know to be qualified and each brings the highest amount of integrity. As I stated, I have spent more than a decade on refining the Strategy and my name and reputation mean a lot to me. I am not willing to jeopardize either one.

My bottom line belief is, if a potential client takes the requisite time to complete his/her due diligence and understands the basics of the Strategy, they will not be disappointed in the results that my company will deliver (both from a performance as well as customer service perspective). In fact, I have not lost a client since I became a registered investment advisor.

Sincerely,
Randy W. Swan, CPA

1. How did you develop the defined risk strategy?

I have been an avid investor and saver since the age of 10. Back then it was my earnings from my lawn care business. It may sound silly, but the preservation of that money was just as important as my savings are today. At 14, I started investing in stocks, mutual funds, and gold and silver coins. After graduating college, I devoted a lot of time researching and trying different trading services. I experimented with various forms of fundamental and technical analysis and I investigated popular asset allocation models. From a risk or reward perspective, none of them ever met my expectations. At age 20, I experienced the crash of 1987. I also endured the impact of the 1st Gulf war before I was 24. Needless to say, neither provided positive returns on my portfolio. However, they were good experiences because they forced me to find a better solution, the Strategy.

I started to learn about options in 1992 when I was 25. At that time, options were relatively new to the markets. I was intrigued by the risk management aspects options offered and soon realized their potential. At the time, I was a CPA, working as a senior tax manager in the financial services group for KPMG, in Houston, TX. During my tenure there, my clients included actuaries and risk managers for insurance companies and other groups that looked to reduce most of the exposures with insurance and reinsurance. I was fascinated by the methods exercised to reduce risk and assorted exposures. This is when ‘the light’ went on.

It was then with my love of investing and risk management that I saw the potential of my professional dream; the combination of investments with risk management techniques that we all employ in our everyday lives. We all insure our health, our car, and house. Why not your investments? Was it even possible?

My research concluded that it was not only possible but it was the only long-term investment approach that made sense.

I believed in the potential so much that in 1996 I decided to quit my job and move. With my wife and 1st daughter, we moved to Durango, Colorado. That is where I started to develop and implement the Strategy. This relocation removed me from most outside influences and allowed me to dedicate myself to proving my theory correct. Theory being, there is a better way to invest.

2. Why aren't more advisors or brokers providing this type of strategy?

The answer must be provided in two parts.

Part I. Most investment advisors do not have the experience, knowledge, or expertise to do what I do. I believe my background as a CPA gives me a unique perspective that few other advisors can offer. They have been content to rely on outdated investment management ideas. Ideas like asset allocation and diversification. Who could blame them? It is well accepted, easily understood and everyone else (their competition) was doing it too. Besides, until recently, those methodologies worked well. Finally, the investment advisory industry leaders have not shown a desire to explain to their clients about other ways to manage risk even if they could. Simply said, it is not easy to invent a better mousetrap.

Part II. Although I am not aware of any other firms that offer a defined risk strategy, there are a few investment products out there that approach or implement some of the techniques used in the Strategy. I have studied, researched, and even made small investments in some of these products. Not one offers the comprehensive benefit of the Strategy. Some offer defined risk but often it leads to minimal upside potential. Others, like the buy-write funds, offer upside potential but their risk management techniques miss the mark.

This past summer, with the first addition to the Swan Consulting team, Drew Kehoe and I went to the Chicago Board Options Exchange (CBOE), for a 2 day training session. During the tour of the trading floor, one of the senior market makers made a comment that 'options are not being used by investment advisors.' That comment made me grin ear to ear. I still have objections to traditional advisors. I cannot understand how 'professionals,' the 'professionals' that hard working people are entrusting with their wealth, their retirement, their future fail to take advantage of something so beneficial? I think you should expect more. I do.

3. How do I eliminate most of the risk?

My personality and my previous career as a CPA made me very risk averse and conservative. What I tell people is that "you want to eliminate the risk that you do not want, and keep the risk that allows you to make a reasonable profit." We accomplish that goal by purchasing investment products from market makers on the option exchanges whereby we decide in advance what price we can sell the stock indexes at some point in the future. In other words, for a price, we transfer the risk that we do not want. This does not guarantee

that we will not lose money but it gives us a reasonable assurance that catastrophic losses do not occur. Then, we hedge, our hedge. We implement additional risk management and hedging techniques to pay for the cost of insurance and provide for additional profit.

4. Why wouldn't I just stay invested in fixed income products? Don't they provide the lowest risk?

Yes, FDIC insured deposits offer less risk. I would take issue with money market accounts since they are not insured and they represent debt with no guarantee of payback. The problem with these types of investments is they provide no real return. Only the defined risk strategy can offer superior risk-adjusted returns. Bonds may or may not be insured but your return of capital is far from certain.

5. It makes sense that the Strategy would work in a Bear market, but what about Bull or Flat markets?

The Strategy has been implemented over the past 11 ½ years in both bull and bear markets outperforming the S&P 500 by 219%. The Strategy has performed favorably with the buy and hold investor during the two previous bull markets with returns approximating 95% of the index. There is an income component to the Strategy that allows for income potential in all types of markets and should outperform a fixed income portfolio over an extended flat market.

6. Does it matter when I enter the strategy? Should I try to time the market upon initiating the Strategy?

I do not recommend trying to time the market since I believe it is difficult if not impossible. That being said, if over the three month period you knew the market was going to drop substantially then it might be marginally better to wait.

7. It sounds like a lot of trades are made, what are the broker fees and tax implications?

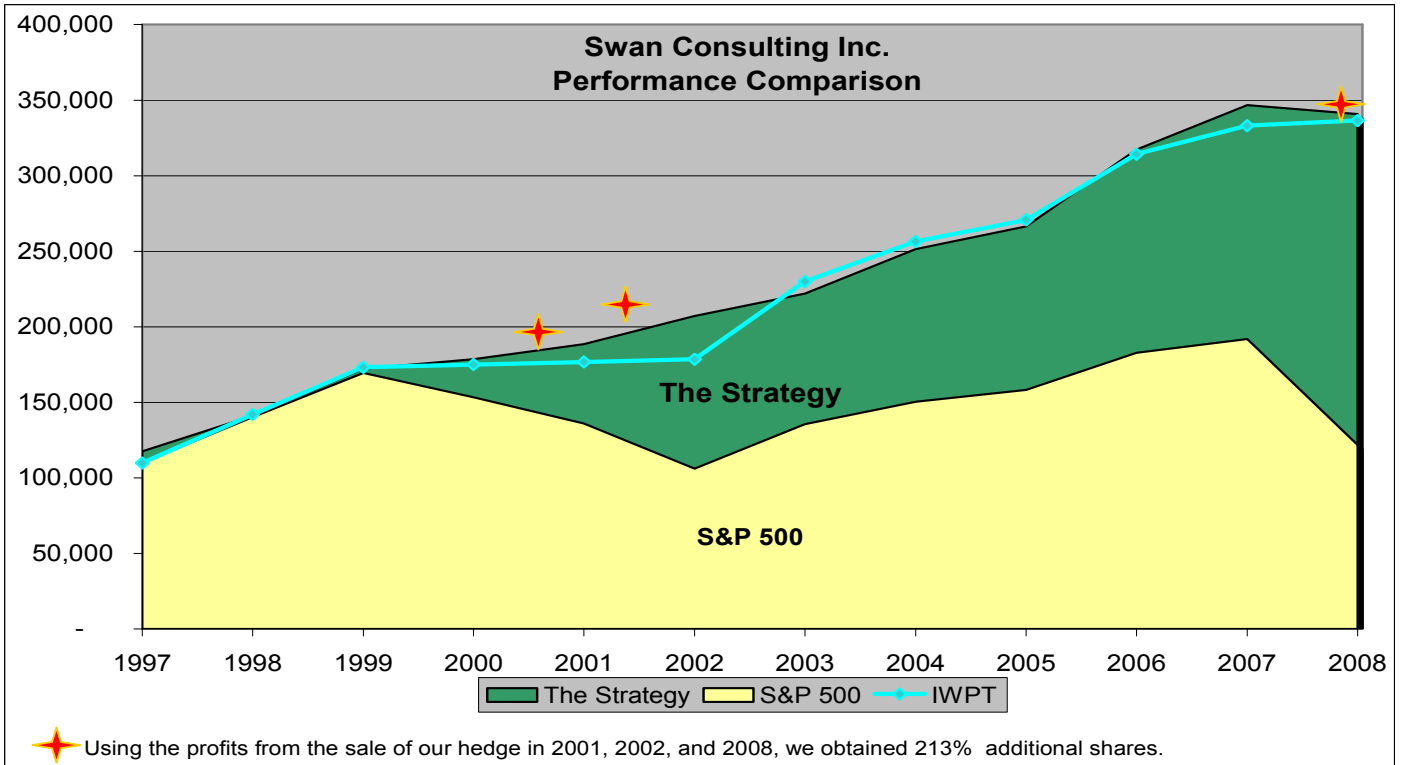
We use Interactive Brokers. They have some of the lowest transaction fees in the industry. Brokerage fees are minimal. In my experience, Interactive Brokers is also one of the best at execution. The tax implications are minimal for several reasons. First, we do not usually sell the shares unless we are trying to generate a loss. Secondly, a lot of the hedging transactions offset each other. Thirdly, the dividends plus 60% of the capital gains are taxed at 15% whereas the remaining 40% are short-term gains taxed at ordinary income rates.

8. Do you have any 3rd Party or independent performance confirmations? Does anybody confirm your results?

No, I do not have any independent confirmation of returns. I do not think it is fair to make my clients pay for this. I offer referrals to prospective clients to ascertain whether or not my claims are valid.

THERE IS STILL ROOM LEFT IN THE LIFEBOAT

SWAN CONSULTING, INC.
DURANGO, CO



Growth of \$ 100,000									
Year	S&P 500				The Strategy				Relative Performance % - Cum.
	Return	Value	Annualized Return	Standard Deviation	Return	Value	Annualized Return	Standard Deviation	
1997	9.98%	109,982	20.96%	0.00%	17.68%	117,685	38.50%	0.00%	7.70%
1998	27.43%	140,146	25.23%	8.72%	19.92%	141,125	25.82%	1.12%	0.98%
1999	20.99%	169,568	23.52%	7.20%	21.92%	172,056	24.24%	1.73%	2.49%
2000	-9.58%	153,315	12.99%	14.04%	3.72%	178,449	17.99%	7.14%	25.13%
2001	-11.32%	135,963	7.07%	15.69%	5.70%	188,617	15.14%	7.56%	52.65%
2002	-22.01%	106,034	1.07%	18.06%	9.80%	207,100	14.15%	7.06%	101.07%
2003	27.89%	135,609	4.80%	18.92%	7.10%	221,811	13.04%	6.87%	86.20%
2004	10.84%	150,306	5.58%	17.77%	13.32%	251,353	13.08%	6.43%	101.05%
2005	5.26%	158,211	5.55%	16.76%	6.01%	266,454	12.22%	6.39%	108.24%
2006	15.47%	182,691	6.55%	16.12%	19.05%	317,218	12.92%	6.45%	134.53%
2007	5.01%	191,836	6.40%	15.38%	9.29%	346,697	12.57%	6.22%	154.86%
2008	-36.55%	121,721	1.72%	19.07%	-1.73%	340,687	11.25%	7.08%	218.97%

Note: 1997 is 1/2 a year and Strategy returns are before fees. IWPT is a hypothetical calculation whereby an investor would have perfect timing on an annual basis. Example: The IWPT buys at year end in 1997 and 2002 and sold at year end in 1999 and 2007 and receives an annual dividend of 2.5% and 1% on cash.

January 16, 2009
Randy Swan

What a year this has been for the financial markets around the world. Fifteen months ago I remember reading and hearing about how this was the best economy ever and now a lot of people are asking are we going to survive.

The good news is that there is still room left on the lifeboat. The bad news is that if you are asking then you probably have already suffered severe losses in your portfolio.

I previously stated over the past decade there is risk in the markets and asked what are you doing about it? There are literally and figuratively options for the average investor.

This is the 4th article that I have written over the past decade that discusses the defined risk strategy implemented by my firm since 1997 (“*the Strategy*”). www.swanconsultinginc.com/library

The purpose of this article is to illustrate why I have been pounding the table since 1997. My claim is that *the Strategy* is superior to a buy and hold philosophy, market timing and asset allocation. My strategy has out-performed all three on an absolute and risk-adjusted basis. I do not offer hope. Hope is something that the politicians offer but rarely deliver. Politics aside, *the Strategy* has delivered results over the past 11 ½ years.

Instead, I offer a Defined Risk Strategy in the stock market that offers downside protection while allowing an investor to profit from either a rising market or a flat market. It also allows for the potential to manufacture income in choppy markets. The latter is important since I do not believe a new 30 year bull market is around the corner or at the end of the road.

During 2008, we had our best relative performance since *the Strategy* was implemented. On October 8, 2008 we adjusted our guaranteed sales price from 1450 to 1000 in the S&P 500 and obtained 40% more shares.

Visit www.swanconsultinginc.com for our results and previous articles.

Summary of Strategy

In case you have not guessed *the Strategy* involves using options to hedge the downside risk and provide income. It is important to note that *the Strategy* uses options as they were intended, to hedge not for speculation. It would be difficult to outline the details of *the Strategy*. However, the following are the some of the benefits of *the Strategy* previously discussed in **Exploring your Investment Options in the 21st Century** written in 2003.

Key Considerations of the Defined-Risk Strategy

(1) Upside participation in the equity markets

The portfolio performance is linked on the upside to the performance of indexes such as the S&P 500, DOW or NASDAQ.

(2) Defined risk upon initiation of investment

Your downside risk is capped and may be eliminated over a one-year period. This is not a claim of an 80% prior success rate that provides no assurance of future success, but rather a definable risk that is determined before investing.

(3) No predictive ability required to be successful

These strategies do not rely on stock selection, market timing, or asset allocation to be successful.

(4) Ability to profit from a market decline

After investing you will not only NOT CARE about a market correction, but also welcome it. Again, you will welcome a market crash. You will be able to profit, not recover, from a rebound after a correction because your investment after the market decline (initial cost and earned profits) will approximate your investment before the market decline. You can profit in two ways: (1) adjust your hedge to the existing market level that allows an investor to profit from a subsequent market rebound and (2) use the excess proceeds from the sale of your hedge to obtain additional shares. In essence, you have the ability of hindsight to buy shares at the current market levels even though you originally purchased shares at a higher level.

(5) *Protect future unrealized gains*

After initial investment, adjusting your hedge can lock in future unrealized gains. In other words, investors do not need to worry about protecting unrealized gains and thus avoiding having to sell thereby creating realized gains and missing potential future stock price increases.

In addition to the 5 key considerations, I have provided a little bit of perspective for investors to ponder.

◆Hedging ◆Time ◆Wealth
◆Flawed Strategies, may they Rest in Peace

Hedging

It is my belief that 'selective hedging' is futile. I have yet to meet anyone who can accurately time the market over the long-term. As a result of my 'continuous hedging,' people ask how much does your hedging cost. I have always answered "we will see." Since *the Strategy* was implemented in 1997, the answer is **zero, nada, zip**. Since the market is about where it started in July of 1997 and *the Strategy* has grown more than 241%, my hedging techniques provided most of the income. Let that sink in for a moment and let this be a lesson to those who believe that hedging is a cost. My experience is that the hedge is a profit center generating returns not incurring costs. A properly hedged position allows an investor to put more of his portfolio in stocks allowing for a greater long-term return.

Nothing But Time

Another benefit is that I believe that *the Strategy* affords me the patience to wait out this bear market whether it last another year or ten years. The reason is that my clients received approximately 40% more shares using the net proceeds from the sale of the hedge on October 8, 2008. This was in addition to the shares that were obtained in the previous bear markets. This allows my clients to profit from any market rebound instead of merely recovering losses. In addition, the increased shares should provide additional income via dividends and other option income generating strategies.

Are my clients:

- scared about losing a large portion of the portfolio,
- worried that they do not have enough time to recover and/or profit,
- worried that they will have dead money over the next ten years as is the case with the past ten years.

NO, they are worried that the market may rebound before they receive another round of *free shares*.

Wealth

Wealth is relative. Even in a year that my clients may not make any money, they are wealthier. Why? In 2008, my clients are at least 40% more wealthy because they were protected against significant losses that others suffered. In fact my clients are 219% more wealthy than the average buy and hold investor over the implementation period.

The Death Of: Buy & Hold, Timing and Asset Allocation

As previously mentioned in all of my literature, I have always had a problem with buy and hold, market timing and asset allocation philosophies. I am not saying there are not some benefits to each but rather the results do not deliver on the promises made by their respective proponents. For example, having a portion of your portfolio in fixed income products to generate cash flow may be necessary but counting on them to protect yourself in 2008 has not been productive.

The Strategy should be used in conjunction with your asset allocation preferences to provide a better return on an absolute and relative basis. In other words, this value added approach offered by *the Strategy* should replace the stock portion of your portfolio. I will briefly highlight the shortcomings of each of the mentioned investment philosophies.

Buy & Hold: What more needs to be said? The buy and hold investor has little to show for their patience since I began implementing *the Strategy*. Over the past century I know of three periods of when the buy and hold could not hold water: the Great Depression, from 1967 to 1982, and from mid 1997 to now. I am not saying that you cannot make money from stocks. In fact, I believe stocks are the only way to make money over the long-term. However, most investors do not have the patience or the fortitude to wait out long periods with no pay off.

Market timing: Market timing is more difficult to access since there are not really any comparable benchmarks. Regardless, I do not know anyone who has a proven track record that has accurately predicted the major moves in the market over the long-term. Milton Freidman said, "Markets can stay dislocated longer than you can stay solvent." Furthermore, the

pressure when the markets are moving against you, when you may ultimately be correct, is extremely difficult. Please review performance comparison on our website. www.swanconsultinginc.com

Modern Portfolio Theory: With respect to asset allocation, my problem has always been the risk reduction that its supporters have always claimed. Asset allocation works until it does not. It looks like 2008 may be the year that it did not deliver on its promises. My view was stated in 1997 when I wrote my book and it has not been changed. My view is as follows:

It is important to note that the great claim of asset allocation relates to the risk reduction achieved by diversifying over several broad asset classes (i.e. stocks, bonds, cash and real estate) without a similar reduction in return. However, the risk reduction is strictly theoretical (typically based upon relationships that existed over a particular period with no guarantee that these same relationships will continue in the future). This is the crux of where asset allocation or modern portfolio theory breaks down. Risk is not defined; instead it is merely expressed in historical standards.

What asset classes do you trust?

The question that I often ask others investors when discussing their asset class alternatives is what do you trust? Yields on government backed securities are less than the inflation rate, corporate and municipal bonds are being downgraded and real estate is an illiquid asset which is probably more overvalued than stocks. Banks deposits are guaranteed but only stocks offer any real long-term returns. Let me rephrase that. Only stock with a reasonable amount of protection and income generating opportunities are your only real bet.

When Will the Bear Market End?

I normally do not like to discuss what I think the market will do since I do not care because I believe *the Strategy* will make money regardless of what happens in the future. However, I think it is important to put the current situation in perspective.

I believe the bear market will be over when the following occurs:

- the dividend yield on blue chip companies is over 7.5%
- P/E ratio of less than 10
- current debt level of individuals, businesses and governments is decreased dramatically.

After all these things have happened, most investors will have given up on stocks and most investments in general. Remember, it took several decades to get to this point and it does not seem realistic that it would be over after one year. The main reason being investor confidence has been shattered and it seems apparent that it will take a lot longer than one year to rebuild that confidence.

What strategy will succeed in the future?

The interesting aspect of *the Strategy* is that it has only been implemented in raging bull markets (1997-2000 & 2003-2007) or bear markets (2000-2002 & 2007-). The future that makes sense to me is that once this bear market is over and a sustainable bottom is found there will not be a bull market (at least not like the last 30 plus years). Instead, I see a market that bounces around for another decade. For example, a 30% rise over 3 years followed by a loss of 20% over the fourth year. This cycle may repeat itself for a long time. You can not count on a bull market to save you. In other words, if you depend on stock price and or market direction to make money, you may be disappointed.

This type of market environment is when *the Strategy's* relative performance should do better than it has historically. Why is this case? Because, investors will not be able to simply buy and hold to save themselves, their portfolios, or their peace of mind. Only a strategy that can profit from rising, falling and flat markets can thrive. A successful investor will need to lock in previously earned gains and be able to manufacture gains.

Conclusion

The Strategy has been in place since 1997, and I am convinced that *the Strategy* offers the best long term profit and risk management potential. Most investment managers are relying on outdated philosophies and risk management techniques. The question I asked in a previous article was; What have you done with your "Investment Options" lately?

The good news is that there is still room left on the life boat.

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