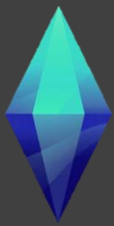

Blue Diamond
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Strategically Designing Your Portfolio

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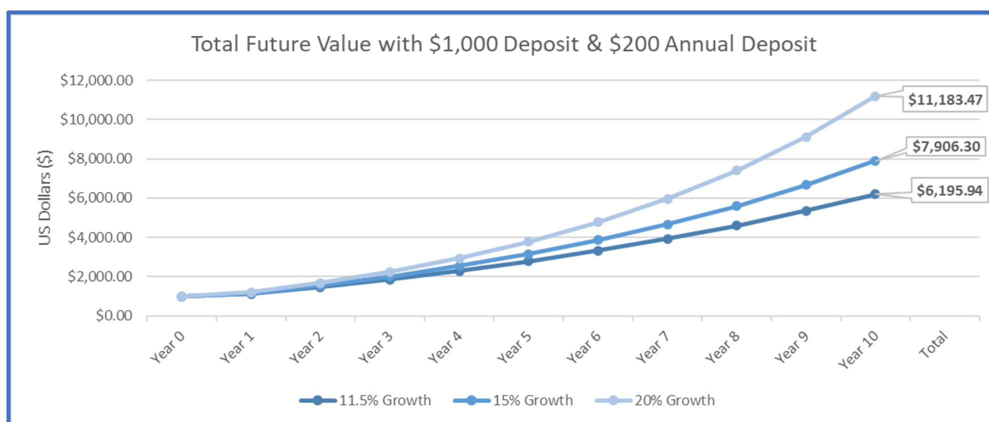
Design is Key

Throughout our years of market experience and investing, strategically designing your portfolio is the key to achieving the most consistent gains. In this report, we will walk through the best way young investors should set up their portfolios. It allows for an infinite amount of returns, while not being dragged down by bonds or other slow-maturing assets. The younger you are, the more risk you should take with your money as the reward is generally greater. However, this risk should gradually decrease as you get closer to retirement. There is time and place for bonds, but it's not in your twenties.

From our experience in investing, the best way to set up a portfolio to achieve solid gains – while not being too risky – is following the 60/30/10 rule, meaning **60% stocks, 30% ETFs, and 10% indexes**. These numbers can always be tweaked to fit your personal levels of risk, but we believe this combination is the best risk/reward. As we get older, we will gradually adjust this breakdown and even add in more secure investment vehicles like treasury bonds to mitigate risk. But as a young investor, it's important to be aggressive because compounding returns over a lifetime are extraordinary.



As demonstrated in the chart above, just a $1,000 initial investment can turn into over $11,000 with an annual deposit. The curve of the chart continuously becomes greater, meaning the more time you are in the markets, your return exponentially increases. For example, if you were to invest the same $1,000 with $200 annual deposit, you would have over $189,000 in twenty-five years. This is why Blue Diamond urges young investors to begin today as the returns can be truly life-changing for people.

> "How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case."
>
> -Robert G. Allen

Understanding the Fundamentals

Stocks

The largest part of a young investor's portfolio should consist mainly of stocks. It is important to realize that individual stocks typically carry the highest risk, but correctly diversifying your picks can help mitigate your risk, while still allowing unlimited returns. Within the (60%) stock portion of your portfolio, we recommend breaking up your large cap "blue chip" stocks and mid to low cap stocks in a 2:1 ratio. Blue-chip stocks are companies such as Microsoft, Coca-Cola, and Target – big names that people easily recognize. Mid to low caps are smaller companies that people typically have not heard of. This is where you have room to trade a riskier stock that you feel confident about while understanding what would affect the share price. It is critical not to buy two stocks that are in the same sector and follow each other's price movements.

For instance, it would be unwise to own stock of both Target and Walmart. Owning both gives you no real advantage since they usually follow the same trading patterns as two of the retail giants. Remember, you should never put more than 15-20% of your outstanding portfolio in a single stock. You should have at least 3-5 single stocks to minimize risk while capturing high growth. As part of your subscription, you will receive weekly stock and ETF picks to boost your portfolio. Blue Diamond conducts the research so all you need to do is invest.

60 / 30 / 10

Mutual Funds/ETFs

Mutual funds and ETFs are both a collection of money by a company that buys a specific group of stocks. These funds are less risky than individual stocks, but they are a good way to target a certain part of the market if you feel bullish about it and don't know which few stocks to buy. The most popular funds are sector-tied, these represent the top stocks from a certain sector. For example, let's say you felt very bullish about semiconductors in 2019, but in an industry full of boom and busts, didn't know which stocks were going to make it. If you had invested in the XSD semiconductor ETF, you would have made a 60% return without even researching an individual stock. There are a variety of ETFs and mutual funds to pick from, such as growth, emerging markets, or small cap funds. We prefer to invest in sector ETFs because they are user friendly, have the lowest fees, and you know exactly which division of the market you are exposing yourself to. For our purposes, there are two key differences between a mutual fund and an ETF. First, is a mutual fund is more actively managed which leads to a higher fee average of .5-1% compared to an ETF's of .2-.75%. Second, ETFs can track an index like the S&P 500 whereas mutual funds are just a collection of different companies on the market.

Indices

Putting a small percentage of your portfolio into an index ETF is a great way to gain exposure to the greater market. These types of ETFs mock one of the major U.S. indices and gives you the same return. We recommend using the DIA to mock the Dow Jones Industrial Average, or the SPY to mock the S&P 500 as these are two of the most traded ETFs. These two markets trade with the same patterns, so it is a personal preference which one you chose. During a time like these first two quarters of 2020 when the markets are beaten down or undervalued, we feel extra bullish about the coming year. Therefore, we like to use a different ETF variant of the S&P 500, called the SPXL. This specific ETF gives investors a return roughly 3x that of the S&P. This means that it rises and falls 3x as much as the index, exposing you to much more risk.

Key Metrics Used in Picking Stocks to Buy

Beta

Beta is a metric that investors use to determine the risk of a stock by comparing its volatility to the overall market. Beta ranges from 0.1 to usually around 3.0 (theoretically there is no maximum value). A beta of 1.00 means that stock is exactly as volatile as the S&P 500. A beta of .70 means the stock is 30% less volatile while a beta of 1.25 would mean it's 25% more volatile than the market. Beta is used to measure the overall risk of your stock portfolio. Remember, the younger you are, the more risks you should take with your money, though this risk should gradually decrease as you get closer to retirement. For younger investors, I recommend investing in stocks that have a Beta of at least .9 or higher. However, this number is not super crucial, as it is generally used as a guideline to quantify how risky your stocks are.

Debt/Equity Ratio

The debt to equity ratio (D/E) is essential to understanding what financial shape a company is in. Depending on the risk level your portfolio holds, you will want to look for companies that have similar financial risk levels. Debt to equity is calculated by dividing debt by equity. This reveals how much debt a company has for every dollar of equity. Almost every company carries debt, even companies like Google and Microsoft. Most companies take on debt to help finance operations, fund investments, and pay dividends; however, taking on too much debt can hurt the company if it can't pay it back. There is no limit to this ratio, so we need to establish a healthy level per industry. The typical D/E of stocks in the S&P 500 is 1-1.5 but ratios of over 2 are common in capital intensive industries. If you want lower risk in your portfolio, look for companies who have a debt to equity ratio of .3 or lower. At Blue Diamond, we recommend looking how companies compare to their peers in the industry. For example, a company with a D/E of 6 in an industry average D/E of 10 could signify the company is in much better financial condition to meet debt obligations.

$$D/E = \frac{\textbf{Debt}}{\textbf{Equity}}$$

P/E Ratio

The price to earnings ratio (P/E) is typically used to measure if a company is overvalued or undervalued. You can find the P/E ratio by dividing the price per share over the earnings per share (EPS). A low P/E may indicate the company's share price is underpriced whereas a high P/E indicates it is typically overvalued. However, a high P/E does not always mean a company is overvalued because it may also infer the company is in heavy growth territory. Comparing this ratio to its industry peers is critical as it reveals how a company is valued compared to its competitors. While a P/E ratio is important to look at, this alone is insufficient and to see the bigger picture, we must look at the PEG ratio.

$$P/E = \frac{\textbf{Price per share}}{\textbf{Earnings per share}}$$

PEG Ratio

The PEG ratio is a little more complex but provides much more insight into the company's future growth. It takes into consideration the company's past EPS as well as the growth rate of the business. You can calculate this ratio by first calculating the P/E ratio and then dividing it by the EPS growth rate. Using this ratio, you can compare its PEG to the industry's and determine how the company is valued within the industry. A PEG of less than 1 indicates the company is undervalued because its current price is low when comparing it to future earnings growth. The opposite is true when the value is over 1 because its price is high when compared to its future earnings growth. Different industries have varying PEGs and you can see if one industry is more valued than another. For example, if a healthcare and energy stock have P/Es of 32 and 23 respectively with future earnings growths of 25% and 15%, the PEG ratios will be 1.28 and 1.53. This means the energy industry is valued higher than the healthcare industry. Using this ratio is best to see the bigger picture when evaluating companies.

$$PEG = \frac{\textbf{P/E Ratio}}{\textbf{Earnings Growth Rate}}$$

The Bottom Line

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However you decide to design your portfolio is up to you, it's meant to be personal and actively managed. The only correct way to analyze your return is to compare it to the market. How much a portfolio has outpaced or lagged the greater market is the sole benchmark for how well your return is. We believe that the 60/30/10 rule will be the most likely allocation strategy to deliver consistent returns above market returns. Blue Diamond Investing's purpose is to help teach beginning investors and teach valuable lessons on creating a significant return year after year. We are always available to answer any questions you have about individual stocks or market conditions and hope this report is a steppingstone for you to begin creating what we hope to be an outstanding portfolio.

Recommended Brokerage Platforms

Throughout our years of investing, we've seen people try numerous platforms including E*Trade®, Robinhood®, TD Ameritrade®, and Charles Schwab. While Robinhood® was first to implement no trading fees, all the platforms listed have also switched to no trading fees and are relatively the same. Each of these platforms are user friendly and make it extremely easy to design your ideal portfolio. If you have any trouble establishing an account on these platforms, please contact our email BlueDiamondInvesting2020@gmail.com.

The COVID-19 Situation

The Coronavirus (COVID-19) has taken a significant toll on the global markets within the last month. It is in these market conditions when we need to reevaluate our portfolio allocations and understand what the lasting affects will be. While initial reports indicate that companies will experience a severe reduction in sales in Q1 and Q2, it is important to note the lasting affects will be much more drastic.

While we will continue to create reports on stocks, mutual funds, and ETFs, please understand that the swings will be large due to the extreme volatility in the current markets. Our goal is to use the measurements explained in the report as well as a variety of other metrics to determine fundamentally sound companies we believe will excel after the damage dissipates. Be sure to keep up to date on our newest page which features our top picks and news we find helpful. Remember, as young investors, we should be excited for these opportunities as many shares are trading at a discounted price.

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