APPLIED
CAPITAL

DEAR PROSPECTIVE CLIENT,

As you evaluate Applied Capital's investment proposal, I would like to share with you some basic ideas that are fundamental to our thinking and instrumental to our strategy.

The main reason for our success is our deliberate departure from the commonly accepted investment views and attitudes. There are two major flaws in the way most people think about stocks and market prices:

- The perception of volatility as a measure of risk, and
- The measuring of investment performance by the change in stock price

Let me explain.

ENRICHING LIVES

Stock prices fluctuate – that is a given. Since 1932, declines of 10% to 20% have on average occurred every two years. However uncomfortable, the fluctuations are as natural and essential to the proper functioning of the market as forest fires to the health of the forest eco-system. Every decline is the prelude to the inevitable advance. Unfortunately, in the minds of most investors, volatility has become the definition of risk. In fact, the entire machine of modern finance has been built to define, explain, calculate, contain, and mitigate excessive price movements. This is the case when an enormous effort is spent to define a problem that does not exist and to attempt to solve a problem that cannot be solved.

The fear of loss, magnified by the constant fluctuations of stock prices, blinds investors to the simple truth: stocks are the safest investment out there. The last statement requires an explanation. Assets can fluctuate greatly in price and not be risky as long as they are reasonably certain to deliver increased purchasing power over their holding period. As we will see shortly, a non-fluctuating asset can be laden with risk.

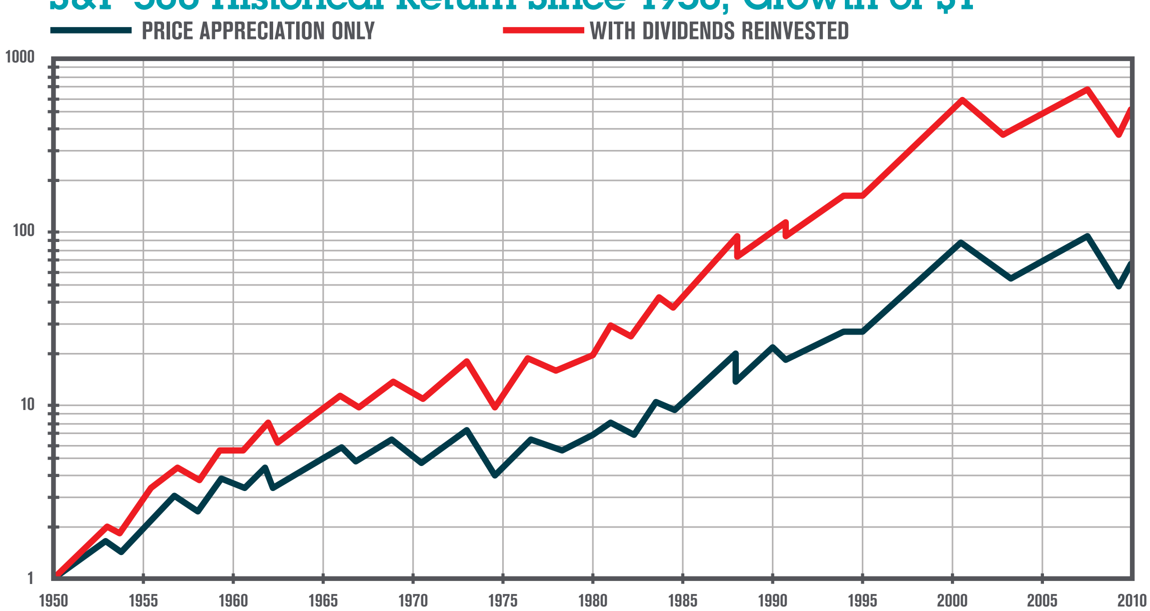
Fixed income investments that include money-market funds, bonds, bank deposits, and other instruments are considered the safest and most suitable for risk averse investors. In truth, they are among the most dangerous of assets. Their magnitude of fluctuations (the volatility) may be zero, but their risk is huge. Over the past century these instruments have destroyed the purchasing power of investors in many countries, even as these holders continued to receive timely payments of interest and principal. Moreover, this dismal result will forever recur. Governments determine the ultimate value of money, and systemic forces will cause them to gravitate to policies that produce gradual inflation. Even in the U.S., where the wish for a stable currency is strong, the dollar has fallen a staggering 80% in value since 1965. It takes nearly $5 today to buy what $1 did at that time. Consequently, a tax-free investor would have needed 4.5% interest annually from a bond or a bank CD to simply maintain their purchasing power. Such an investor would have been completely mistaken to consider any portion of that interest as "income".

Over the same time period, when the so called "safe", non-fluctuating investments were decimating the purchasing power of their holders, a broad-based portfolio of stocks would have delivered at least 10% of average annual nominal return and about 6% of real, inflation-adjusted average annual return. To be clear, even with great, sometimes unbearable volatility an investor staying with stocks would have greatly increased their real wealth.

As we see it at Applied Capital, investors confuse the inherent volatility of stocks with a risk of loss, when, in fact, loss becomes increasingly unlikely when an investment time horizon is long enough and the selected investments are of the highest quality. According to Bespoke Investment Research, since 1937, the average rolling 10-year return for the S&P 500 (a broad portfolio of stocks) has been 103%. Losing money in stocks becomes increasingly problematic when the investment horizon is extended even further. In fact, making money in stocks over long investment horizons of 15 years or more becomes essentially certain. Interestingly enough, this certainty, predicated on staying invested, does not motivate the majority of investors to adopt a buy and hold strategy. Their preference for controlling risk is to own stocks for very short periods of time. The advice of Warren Buffett, *"If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes,"* goes unheeded by most.

The second biggest investment mistake is to measure success by the increase in value of one's portfolio. That point of view ignores one very important fact: a stock may not appreciate for long periods of time and yet provide increasing economic benefits to its owners by increasing dividends year after year. Our strongest belief is that dividends and their growth are the most important drivers of wealth creation for our clients. Over the last 40 years more than 70% of total returns from stocks have come from dividends and dividend reinvestment. Investing in stocks that never pay dividends misses the most critical component of the total investment return.

S&P 500 Historical Return Since 1950, Growth of $1



The peace of mind and the satisfaction of receiving growing income from dividends is what defines, sets apart, and determines Applied Capital's investment strategy. We manage the portfolios of our clients to **maximize the dividends and to expedite the dividend growth** on the portfolio level. To achieve that goal, we invest in businesses with exceptional abilities to generate increasing profits and with a history of regular and methodical dividend increases. From the investor's point of view, every time the dividend increases, the **economic value** of dividend paying shares increase correspondingly. Plainly speaking, there is no other way to interpret the situation.

A PROPERLY CONSTRUCTED PORTFOLIO OF HIGH QUALITY STOCKS WITH RELIABLE AND GROWING DIVIDENDS WILL HAVE A CORRESPONDING INCREASE IN ITS STOCK PRICE, OVER TIME.

So, how do we invest our clients' funds? We start with research and we end with research. We do our home-work looking for specific companies with very specific properties:

- Strong, reliable businesses with high net profit margins.
- Demonstrated ability to grow top and bottom lines over time.
- Moderate capital requirements.
- Leadership position in their respective markets.
- Low to moderate levels of debt.
- Strong track record of paying and increasing dividends.
- Strong track record of meaningful share buybacks.
- Low risk of product or service obsolescence.
- Honest, candid management.

In short, we look to acquire reliable and growing income streams in the form of dividends. As the dividends grow, and our continuous research makes sure that they do, the portfolio value grows as well, over time. It simply has to happen. Every time a company increases its dividend, the **economic value** of its shares **increases proportionally and immediately.** Whether the market recognizes this increased economic value and assigns a higher price to the company's stock is an entirely different matter. In fact, the market often fails at this task, delaying the recognition and thus creating an opportunity for smart investors to capitalize on its mistakes.

Sooner or later, however, the price of a stock must increase in line with increasing dividends. A mathematical paradox would result if that was not the case. Continuously increasing dividend without a corresponding increase in share price would eventually cause the dividend to become larger than the stock price itself. Needless to say, you could never find a stock that pays a dividend that is bigger than its market price. As a matter of fact, the dividend is always a small percentage of the stock price, usually in the range of 2 to 4 percent. How is it possible to maintain the proportionality of dividends to the stock prices in such a narrow range if the dividends continue to grow year after year? The only logical explanation for this seemingly obvious observation is that the market does its job by increasing the price of stocks that increase their dividends, over time. Thus we must conclude that:

A properly constructed portfolio of high quality stocks with reliable and growing dividends will have a corresponding increase in its stock price, over time.

However, this is not the end of the story. This story has a very happy second chapter called dividend reinvestment. You see, the dividends coming into each client's individual portfolio accumulate into a small pile of cash that is growing larger with time. When it is large enough, the cash is deployed to buy more shares of high quality companies. At that point, new shares start contributing to the ever growing cash flow (the dividends) enabling more stock purchases in the future. In short, we have described a process known as compounding, when the amount of dividends received by an investor increases exponentially over time. Even the great Albert Einstein once declared compound interest to be "the most powerful force in the universe."

Notice what we have just described?

We have described the process of **compounding our income** by selecting dividend paying companies that increase their dividends every year. Then we start reinvesting the dividends to receive even more dividends in the future. Dividends on dividends, so to speak. Now comes the most important part:

*The process of **income compounding** is independent from market prices and fluctuations. The income generated by the properly selected and managed portfolio **always** goes up by a reliable, although unknown upfront, percentage. We manage our clients' portfolios with a goal to engineer a low to mid-double digit income growth. That creates highly reliable conditions for portfolio appreciation in lockstep with the growth of income generated by it.*

As you can see, at Applied Capital we have developed what we consider a reliable, elegant and logical process for creating wealth. The feedback we receive from our clients indicates that they – after watching their wealth grow for many years - have developed very high levels of confidence in their financial future. We know that confidence in the future makes lives better today. “Making investments that make sense” is our tag line and a daily reminder of our responsibilities, but our motto, passion, and true aspiration is to enrich the lives of our clients, make them financially secure and confident in their future.

JOIN US.
ENRICH YOUR LIFE.

LENNY KISIN
PRESIDENT, APPLIED CAPITAL LLC

2900 N Ocean Dr. Unit 302
Hollywood, FL 33019
appliedcapitalllc.com | 561.690.9955