

# The NIC Fund

## Annual Management Report



[www.novainvestmentclub.com](http://www.novainvestmentclub.com)

**Carlos Alves**

[carlosalves@novainvestmentclub.com](mailto:carlosalves@novainvestmentclub.com)

**Dinis Rodrigues**

[dinisrodrigues@novainvestmentclub.com](mailto:dinisrodrigues@novainvestmentclub.com)

**Diogo Nunes**

[diogonunes@novainvestmentclub.com](mailto:diogonunes@novainvestmentclub.com)

**Filipe Gonçalves**

[filipegoncalves@novainvestmentclub.com](mailto:filipegoncalves@novainvestmentclub.com)

**Henrique Queiroz**

[henriquequeiroz@novainvestmentclub.com](mailto:henriquequeiroz@novainvestmentclub.com)

**Miguel Mendes**

[miguelmendes@novainvestmentclub.com](mailto:miguelmendes@novainvestmentclub.com)

**Rui Coelho**

[ruicoelho@novainvestmentclub.com](mailto:ruicoelho@novainvestmentclub.com)

## 1. Description

One of the main objectives of the Nova Investment Club (NIC) is to provide its members with the knowledge and experience necessary to work in the fields of empirical finance research and portfolio management. Following this line of reasoning the Club created a virtual fund named “The NIC Fund”, which was managed using the Bloomberg platform. It presented an initial fictional capital of 100 Million Euros. Due to the Portuguese origins of the NIC, all the investments made were taken in the perspective of an European investor operating in the global market. In this sense, all transactions made in foreign currencies are later exchanged to Euros. For simplicity of representation, “The NIC Fund” will hereafter be mentioned simply under the designation of “Fund”, whenever appropriate.

The structure of the fund faced several changes in 2012. Despite the Fund’s good performance in the year of 2011, we felt that the previous objectives were too broaden, as they tried to achieve goals which often were not compatible with the financial markets environment. As a result, and in order to achieve a more robust portfolio approach, in which investors know exactly what type of returns to expect, we decided to reshape the setting of investment objectives, so that all the investment instruments selected to the fund were aligned and consistent with its ultimate goal.

Since this is only a virtual fund involving no real application of capital in the financial markets, no legal requirements regarding financial reporting practices are imposed by law. Nevertheless, as this project tries to simulate a real life investment experience, all the minimum quality standards, concerning the faithfulness and reliability of the information provided, are followed by a careful performance monitoring. Furthermore, although there are no special ethical restrictions to the type of investment vehicles chosen for the Fund, the Club will not engage with investments that may appear to have a negative impact towards the welfare of our global society.

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## 2. Investment Policy

### Objectives

The definition of capital appreciation as the ultimate target of the fund allows it to enjoy some important tax benefits. Investments are channeled through specific financial instruments which share this objective, such as ETF's, and so do not pay dividends but rather reinvest unrealized capital gains, thus removing tax considerations. This provides an opportunity for investments to achieve their maximum growth potential, reason why the fund was re-launched and reshaped, in order for its investment policies to aim at achieving this single new purpose.

Given that the portfolio management industry is extremely competitive and active management's commissions and bonuses depend on the ability to provide investors with higher risk-adjusted returns, rather than just perceiving a simple "buy-and-hold" strategy, the fund also tries to fulfill a Sharpe ratio objective defined by the S&P500 benchmark. It is however important to notice that, since we are taking the perspective of an European investor, by choosing a US Dollar denominated benchmark, we will have to take into consideration all currency changes in relation to the Euro.

### Strategy

Regarding the investment strategy followed by the Fund, it was decided that it should be composed by a more stable time frame, in which 80% of the capital would be invested for a one-year investment horizon. The remaining would be allocated according to a shorter term strategy - monthly/quarterly horizon.

In order to enhance the diversification of the strategic allocation composing the first part of the fund, Exchanged Traded Funds related to each of the following areas were selected: Emerging Market Equities, Energy & Commodities, Fixed Income, Global Equities and Real Estate. This conservative section of the fund expects to achieve a low annual return of around 4 to 6%, with low levels of volatility, high percentage of positive return days and a maximum monthly drawdown of no greater magnitude than -5%.

The remaining capital is reserved for short-term stock picking based on speculative moves, which try to take advantage of any profitable trading opportunity that might be presented in the market. This strategy tries to achieve high levels of short-term returns but, due to its speculative nature, will also be exposed to high levels of volatility and thus can lead to a significant drawdown.

Concerning Currencies, it was decided that the fund would not invest directly in the Foreign Exchange market. The investment strategy related with this asset class would be incorporated in the selection of the other ETF's, in such a way that, whenever it seemed profitable, currency exposure would not be hedged. As a result, all the absolute returns presented below for ETF's whose main denomination is in a foreign currency, already include the currency changes verified during their holding period.

## 3. Performance Monitoring

### Strategic Allocation

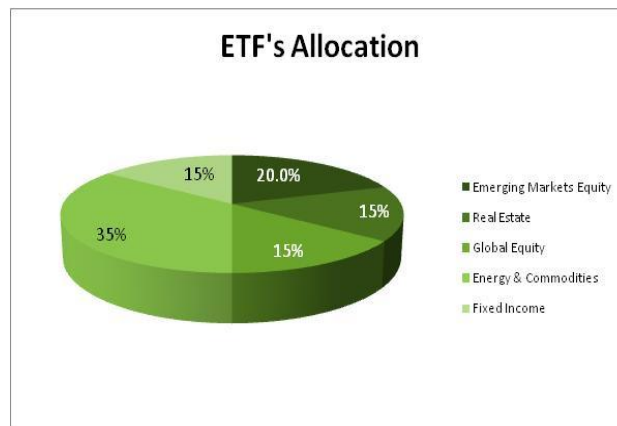
The Fund was relaunched on February 24<sup>th</sup> of 2012, with the acquisition of the ETF's which would be composing the first part of the fund. In order to select the ETF portfolio, each member of the Fund was responsible for the research of one of the different segments of asset classes. Each participant selected three found more adequate for the fund. Taking into account the selection made and the historical data available for each ETF, a Markowitz allocation with constraints was then computed, where no single investment could constitute less than 5% or more than 20% of the strategic allocation section.

As its one year investment horizon period would make us expect, this was a section which did not suffer many changes throughout time. Most ETF's remained part of the fund until the date of redaction of this report. The main transactions were related to shifting further into the Emerging Markets equities, by substituting the iPath Dow Jones - UBS Copper Subindex by the iShares MSCI Eastern Europe 10/40 on the 6<sup>th</sup> of March of 2012. Subsequently, the Fund acquired a share in the Market Vectors Indonesia Index ETF, iShares MSCI Turkey Index Fund and iShares MSCI South Korea Index Fund during the month of April.

The initial allocation of the ETF's across the different asset classes and the performance of each during the time it was part of the fund, can be observed in the pie chart and table below. As we can see, due to the diversification that each one of them already possesses, the Holding Period Returns (HPR) are relatively stable, with the best performer returning 17,59% and the worst one losing only 5,64%, and mainly concentrated in the area between 8% and -3%.

#### ETF's

| Security   | Description  | Acquisition Date | Sale Date | Position | Initial Investment (Euros) | Overall Performance |
|------------|--|------------------|-----------|----------|----------------------------|---------------------|
| TUR US     | iShares MSCI Turkey Index Fund                       | 10-04-12         | 01-09-12  | Long     | 2.572.749,22               | 17,59%              |
| SSO US     | ProShares Ultra S&P500 ETF                           | 24-02-12         | 01-09-12  | Long     | 4.994.961                  | 13,21%              |
| IFAS US    | iShares FTSE EPRA/NAREIT Asia Index Fund             | 24-02-12         | 01-09-12  | Long     | 14.986.199                 | 8,63%               |
| CWB US     | SPDR Barclays Capital Convertible Securities ETF     | 24-02-12         | 01-09-12  | Long     | 14.984.985,03              | 6,22%               |
| FXZ US     | First Trust Materials AlphaDEX Fund                  | 24-02-12         | 01-09-12  | Long     | 14.985.017                 | 3,50%               |
| EWD US     | iShares MSCI Sweden Index Fund                       | 24-02-12         | 01-09-12  | Long     | 4.994.990,81               | 1,96%               |
| JJC US     | iPath Dow Jones-UBS Copper Subindex                  | 24-02-12         | 06-03-12  | Long     | 4.995.777,15               | 1,75%               |
| PXI US     | PowerShares Dynamic Energy Sector Portfolio          | 24-02-12         | 01-09-12  | Long     | 15.055.353,40              | 1,03%               |
| EWY US     | iShares MSCI South Korea Index Fund                  | 30-04-12         | 01-09-12  | Long     | 2.627.515                  | 0,01%               |
| MAREMIS AU | Macquarie Emerging Markets Infrastructure Securities | 24-02-12         | 01-06-12  | Long     | 14.985.000                 | -0,34%              |
| IDX US     | Market Vectors Indonesia Index ETF                   | 30-04-12         | 01-09-12  | Long     | 2.445.011                  | -2,69%              |
| IDEE LN    | iShares MSCI Eastern Europe 10/40                    | 06-03-12         | 10-04-12  | Long     | 2.597.037,18               | -3,72%              |
| EEM US     | iShares MSCI Emerging Markets Index                  | 24-02-12         | 01-09-12  | Long     | 4.995.776,78               | -3,86%              |
| PZD US     | PowerShares Cleantech Portfolio                      | 24-02-12         | 01-09-12  | Long     | 4.994.985,25               | -5,64%              |



## Stock Picking

After having successfully completed the long-term allocation strategy of the Fund, we had all the necessary stability to start focusing on more speculative moves to enhance our return and provide us with that much needed alpha over our benchmark, the S&P500. In this sense every member was responsible for a different sector of the stock market, from which had to develop a strategy that would be able to provide profitable returns over a quarterly investment horizon.

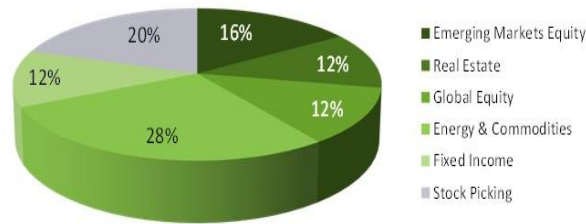
Having selected all the stocks that we wanted to buy and short-sell in each sector, we proceeded to their acquisition on the 28<sup>th</sup> of March of 2012. Most stocks were kept until the end of July, except for the ones related with the banking sector, for which it was decided that the strategy in place should take a more short-term approach by not maintaining it for more than a two months period.

In the pie chart and table below, it is possible to observe the Fund's allocation after the process of stock picking was complete, as well as each stock's HPR. As it can be verified, these returns vary much more wildly than the ETF's, with the best performing stock achieving a return 36,82% and the worst losing almost half of its value (- 44,84%), in a period of simply two months.

### STOCK PICKING

| Security | Description                                 | Acquisition Date | Sale Date | Position | Initial Investment (Euros) | Overall Performance |
|----------|---|------------------|-----------|----------|----------------------------|---------------------|
| STD US   | Banco Santander SA                          | 28-03-12         | 01-06-12  | Short    | -844.147                   | 36,82%              |
| SAB SM   | Banco de Sabadell SA                        | 28-03-12         | 01-06-12  | Short    | -2.248.302                 | 24,83%              |
| GS US    | Goldman Sachs Group Inc                     | 28-03-12         | 01-06-12  | Short    | -2.248.302                 | 19,91%              |
| VLKAY US | Volkswagen AG                               | 28-03-12         | 01-07-12  | Long     | 4.493.458                  | 11,96%              |
| BIMAS TI | BIM Birlesik Magazalar AS                   | 28-03-12         | 01-07-12  | Long     | 4.496.603                  | 9,93%               |
| GLW US   | Corning Inc                                 | 28-03-12         | 01-07-12  | Long     | 4.496.603                  | -0,41%              |
| DNR US   | Denbury Resources Inc                       | 28-03-12         | 01-07-12  | Long     | 4.496.603,41               | -0,47%              |
| GE US    | General Electric Co                         | 28-03-12         | 01-07-12  | Long     | 4.496.603,41               | -2,52%              |
| ZON PL   | Zon Multimedia Servicos de Telecomunicaçoes | 28-03-12         | 01-07-12  | Long     | 4.496.603,41               | -3,86%              |
| WLP US   | WellPoint Inc                               | 28-03-12         | 01-07-12  | Long     | 4.496.603,41               | -13,22%             |
| POP SM   | Banco Popular Espanol SA                    | 28-03-12         | 01-06-12  | Long     | 2.248.301,70               | -22,24%             |
| BBVA US  | Banco Bilbao Vizcaya Argentaria SA          | 28-03-12         | 01-06-12  | Long     | 844.147,22                 | -44,88%             |

## Fund's Allocation



## Overall Performance and Benchmark Comparison

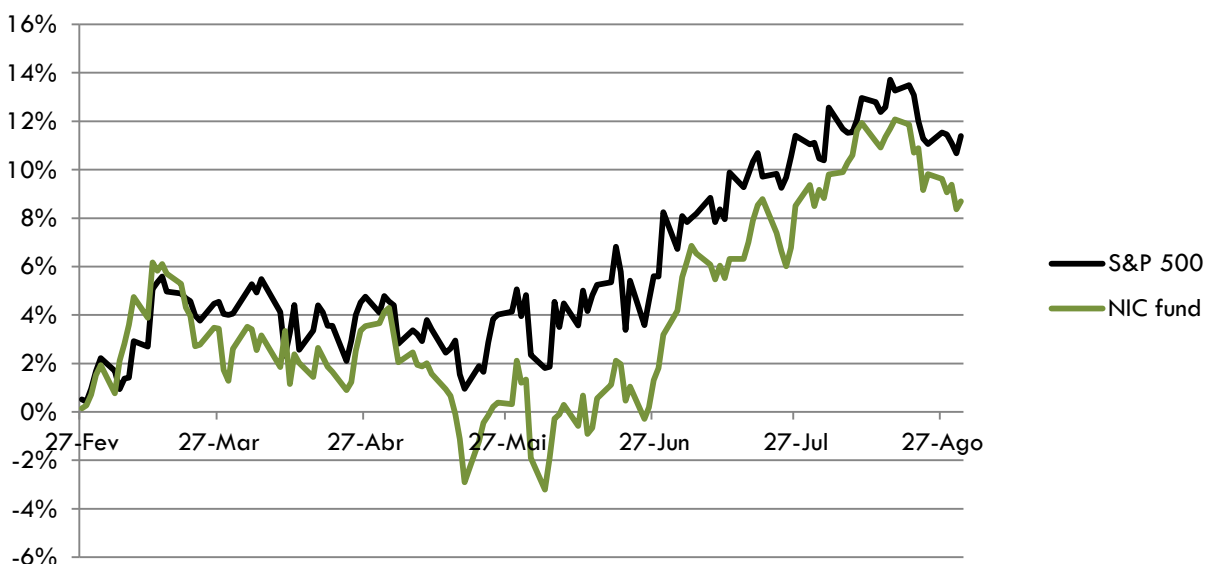
Between the February 24<sup>th</sup>, 2012 and the of August 31<sup>st</sup>, 2012 our fund was able to provide a HPR of 8,69%, which would represent an annualized return of 17%, were we to keep up with the same growth rate verified at that moment. Since this return was obtained as result of an annualized volatility of 14,85%, the Sharpe ratio of the Fund was 1,15. Although this represents a very positive risk-adjusted performance in historical terms, unfortunately we were not able to outperform the S&P500.

Nevertheless, it is important to notice that this unusual high performance of our benchmark, with a HPR of 11,39% and a Sharpe ratio of 1,48, was only possible due to the instability in the European markets, which made the US Dollar appreciate 6,68% in relation to the Euro, boosting the S&P500 returns significantly.

The main overall performance indicators, as well as the evolution of the Fund's and benchmark's returns over time, can be observed in the graph and table below.

### Overall Performance Indicators

| Overall Performance Indicators | Fund   | S&P    |
|--------------------------------|--------|--------|
| Return                         | 8,69%  | 11,39% |
| Return (annualized)            | 17,00% | 22,28% |
| Volatility (annualized)        | 14,85% | 15,03% |
| Sharpe Ratio                   | 1,15   | 1,48   |
| % Positive days                | 57%    | 54%    |



## 4. Management and Participants

### Legal and Institutional Disclaimer

The NIC Fund is a pure virtual fund, with no real implications, excusing itself by this reason from fulfilling any kind of legal requirements established by law. As there are no returns from a virtual fund, there is also no rationale for distributing them. On this reasoning, the Fund shall compound returns adding them to the value of the Fund periodically. In the same way, as there is no real capital involved, no commissions will be charged.

The Management Team or any other NIC member or equity research author are not responsible for any wrong interpretation, whether it be in the form of recommendation or advisory, or other, that may be done by investors using the information and decision taken in the sphere of the Fund's activity.

The role of the decisions, research and other information done is only pedagogical and must not be interpreted as true or even as a hint. Anyone who does so cannot claim liability with the Nova Investment Club or any other intervenient in this process.

### Management Company Details

The Management Company role is represented in this fund by the Nova Investment Club, recognized as a non-profit organization by the Portuguese legislation. Due to the virtual and legally disclosed nature of the NIC Fund, the interpretation of the Management Company must not be seen from a legal perspective, but merely as the entity that develops this activity.

The Management Team is composed by all Nova Investment Club members. The role of the Management Team is to prosecute the objectives described for the existence of this investment tool and cannot be extended further than that, unless explicitly justified and approved.

### Participants

The objective of The NIC Fund is to provide members and M.Sc. in Finance students with a powerful and real learning tool that incorporates the output of their knowledge. In this sense, we see the target public as the whole investment community whose interest is sparked by this initiative and wishes to follow it on a regular basis. There are no requirements to these individuals, and, if anything, we strongly appreciate any help or useful comments that there may surge.

Visit [www.novainvestmentclub.com](http://www.novainvestmentclub.com) for more updates

### Our **Nova Investment Club** team:

António Gil Nogueira | Bernardo Betley | Carlos Alves  
 Daniel Vieira | David Bianchi de Aguiar | Dinis Rodrigues  
 Diogo Nogueira Leite | Diogo Nunes | Filipa Gomes  
 Filipa Pedreira | Filipe Gonçalves | Francisco Martins  
 Francisco Lopes | Guilherme L. da Costa | Guilherme R. Pereira  
 Henrique Queiroz | João Bragança | João Jerónimo  
 José Maria Cordovil | Madalena Felício | Marta Cachola  
 Miguel Mendes | Pedro Calisto | Ricardo Teixeira  
 Rui Coelho | Stefanie Schlattmann | Teresa Cortez  
 Tiago Almeida

[nic@novainvestmentclub.com](mailto:nic@novainvestmentclub.com)

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