

The Buyback Letter

Letter Information

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Price: \$195/yr; \$ 59/3 months
Frequency: Monthly
Hotline: Yes
Manages \$: Yes
Focus: Stocks
HFD began following: 12/31/1996

Portfolio Analysis—8/31/06

(Average of all portfolios)

Composition

Long: 99.6%; Cash: 0.4%

Number Of Securities Held

13

Average Holding Period of Current Positions

365 days

Portfolio Volatility vs DJ Wilshire

Over last 12 Months

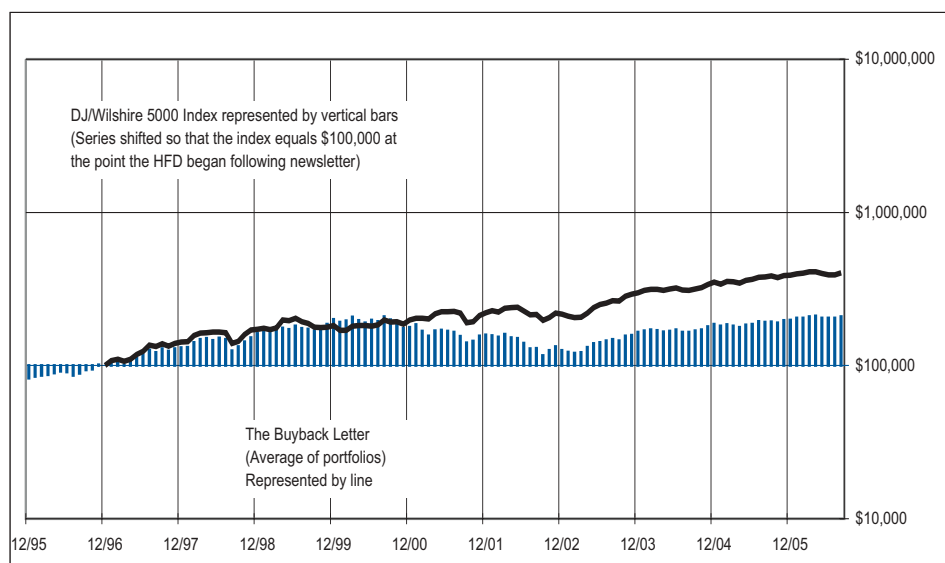
1% more

Over entire period followed

6% less

Largest 12-Month Loss

-12.5% (vs. -28.9% for DJ Wilshire)



1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	% Gain/Loss
n/a	42.3	21.6	5.8	8.6	11.3	-2.0	38.1	17.2	10.7	% Gain/Loss
21.2	31.3	23.4	23.5	-10.9	-11.0	-20.9	31.6	12.6	6.2	DJ Wilshire

Performance (through 8/31/06)

	Lifetime*	1 yr	3 yrs	5 yrs	8 yrs	10 yrs	15 yrs
% Gain/Loss**							
Letter's Average	+303.7(15.5)	+6.6	+52.1(15.0)	+83.0(12.9)	+188.7(14.2)	n/a	n/a
DJ/Wilshire 5000	+109.2(7.9)	+8.9	+40.6(12.0)	+34.7(6.1)	+67.1(6.6)	+135.6(8.9)	+350.6(10.6)
Adjusted For Risk**							
Letter's Average	+0.23	+0.10	+0.40	+0.23	+0.23	n/a	n/a
DJ/Wilshire 5000	+0.10	+0.19	+0.32	+0.10	+0.08	+0.12	+0.15

*Over entire period tracked by HFD. **Annualized equivalents are shown in parentheses.
 ***Average monthly % performance per unit of risk. The higher the number, the better.

Commentary

The *Buyback Letter* is an attempt to exploit one of the academically-recognized exceptions to the Efficient Market Hypothesis (EMH). The EMH has been the reigning orthodoxy for decades in finance graduate schools, holding that the markets are so efficient that they cannot be consistently beaten over time. Recently, however, several exceptions (or “anomalies”) have been discovered.

The anomaly that is the foundation of *The Buyback Letter*: Companies that buy back shares of their stock in the open market on average outperform companies that have not. The best-known academic study in this regard appeared in the *Journal of Financial Economics*: “Market Underreaction to Open Market Share Repurchases,” by David Ikenberry and Josef Lakonishok (both from the University of Illinois at Urbana-Champaign), and Theo Vermaelen (INSEAD).

In *The Buyback Letter*, editor David Fried attempts to do even better than the results of this and other academic research studies. “I’m in search of even bigger

game,” he writes. For example, Fried has found that he can improve on the average performance of buyback stocks if he concentrates on those that have the lowest price-to-sales ratios.

Fried does not attempt any market timing. “Unless you are finished with your investment career, the best prescription for your long-term wealth is to stay with the stock market through its inevitable ups and downs.”

Nevertheless, this newsletter’s model portfolio for which the HFD has the most data has not always been fully invested. This doesn’t mean that Fried is a closet market timer, however. It simply is a reflection of the fact that Fried doesn’t always tell subscribers where they should get the money to purchase new recommendations, thereby forcing the HFD’s portfolio sometimes to borrow and at other times partially to be in cash.

The HFD began monitoring *The Buyback Letter* at the beginning of 1997. Since then, the newsletter’s portfolios on average have produced a 15.5% annual-

ized return, in contrast to 7.9% for the DJ Wilshire 5000. They outperformed the DJ Wilshire 5000 on a risk-adjusted basis as well.

An interesting additional perspective comes from the performance of those investment newsletters that focus on new issues, since companies that issue new stock are the theoretical opposite of those that are buying back their shares. *New Issues*, which used to be published by the Institute for Econometric Research, is the new-issue newsletter for which the HFD has the most data. Between the beginning of 1983 and mid-1999 (when it was discontinued), this service lagged the DJ Wilshire 5000 by a margin of 12.9% to 17.3% (annualized).

Fried also publishes a companion service entitled *The Buyback Premium Portfolio*, which the HFD began monitoring on 1/1/2001. Since then it has gained 10.2% annualized, in contrast to 2.9% annualized for the DJ Wilshire 5000 and a 13.3% annualized gain for *The Buyback Letter* itself over the same period.