

MITTS Investments

MITTS: The Only "Can't Lose" Stock Market Investment on Earth

** Republished with permission from the Oxford Club Research Department*

Despite the gloom associated with a global recession, a widespread bear market and a largely unpredictable war, there exists an investment opportunity that's 100% immune to it all.

These securities feature unlimited upside potential, zero risk to principal and, best of all, guaranteed profit. In other words, they are the Holy Grail of investing...and they form the perfect centerpiece for our Oxford Fortress Portfolio.

These securities are neither obscure nor newfangled. In fact, they were created by one of the largest financial institutions in the world. They're highly liquid and traded on both the NYSE and AMEX.

They're called market index target term securities (MITTS). If you don't already own them, it's probably because you didn't know they exist. But now you do, and here's why MITTS investments should be a part of your portfolio...

MITTS Investments: A Rock-Solid Financial Foundation

In fall 2001, the Oxford Club introduced a bullet-proof portfolio of recommendations. It later became known as the Oxford Fortress Portfolio. As the Fortress Portfolio has evolved, it's also become more simplified to the point where it consists of just a single investment type: MITTS investments. Unlike single-stock investments, MITTS offer you the chance to invest in sectors, indexes, or even regions of the world, for example:

- S&P 500 MITTS (AMEX: MLF) are based on the S&P 500. And owning it allows us to capitalize on an eventual rebound in U.S. large-cap stocks. This one matures July 1, 2005.
- Euro/Pacific MITTS (AMEX: EUM) are based on the 11 biggest markets outside of the U.S.— Germany, the U.K., France, Switzerland, Spain, Italy, the Netherlands, Sweden, Australia, Hong Kong and Japan. The maturity date is May 26, 2006.
- Nikkei 225 MITTS (AMEX: MNK) The Nikkei 225 stock index is a benchmark tracking the performance of the 225 largest stocks on the Tokyo Stock Exchange, and is the equivalent of our S&P 500. The maturity date is 3/30/09.

That brings our total to three MITTS investments in the Fortress Portfolio, and that's not by accident...

Not Just Seeking the Holy Grail...Finding It

It's these MITTS investments, and their guaranteed profits, that form the heart and soul of our Oxford Fortress Portfolio. So what are investment MITTS? Here's a brief primer on MITTS investing:

For seekers of the mythical Holy Grail, this strategy is no fantasy. It delivers exactly what it promises. MITTS are publicly traded securities created by Merrill Lynch for investors who want capital appreciation coupled with complete protection of principal.

Let's take our Russell 2000 MITTS (AMEX: RUM), for example. Merrill Lynch brought these securities public at \$10 a share when the Russell 2000, the U.S. small-cap index, was at 449.4. RUM shareholders are guaranteed to receive 100% of the percentage increase in this index over the benchmark index value (494.3) at the time they mature on Sept. 30, 2004.

In other words, if the index doubles (to 988.6), the MITTS will be worth \$20 at maturity. If the index triples, they mature at \$30. And so on.

However, even if the index declines over its lifetime, Merrill guarantees that the shareholder will not receive less than \$10 per share at maturity. That's the absolute minimum. In other words, you have the unlimited upside of the index, but with no risk to principal (provided, of course, you pay \$10 or less when you buy them). And right now, you can.

How Are MITTS Purchased?

You are not required to buy these securities through Merrill Lynch, by the way, nor are you required to hold them until maturity. MITTS trade on the American Stock Exchange and New York Stock Exchange, giving shareholders daily liquidity. If the index begins to rise, so will the MITTS. If the index falls, so will the share price, temporarily.

However, no matter how badly the index gets hit, Merrill Lynch guarantees that you will NOT receive less than \$10 at maturity. So there's no reason to sell if the price is down temporarily. And, of course, if the price is up, you can take profits whenever you like.

Unlike stock and mutual fund shareholders who are always left wondering when, or if, their share prices will recover, holders of MITTS have the supreme peace of mind that comes from knowing that under no circumstances will they suffer a loss of principal.

That's because MITTS are neither stocks nor mutual funds, but essentially debt obligations of Merrill Lynch with the return tied to the value of a particular market index.

For obvious reasons, these "Protected Growth Investments," have been popular with investors anxious about market volatility. As a result, Merrill has offered MITTS investments linked to a variety of indexes and various sectors including energy, consumer staples, healthcare/biotech, etc. You could actually construct a complete index portfolio of large caps, small caps and foreign stocks, all with zero risk to principal over the life of the investments.

One interesting thing about MITTS investments is that the market is sometimes quite inefficient in pricing them. Just as closed-end funds will often sell at substantial discounts to their net asset values, so will MITTS trade at a substantial discount to their intrinsic value. This creates superb opportunities for us. Especially since, unlike a closed-end fund, which may never see its discount to net asset value go away, we know that over the next few years either the discount will vanish, and we will get the full value of the index, or if the market tanks, we'll get back our \$10 per share.

This goes for all three of our recommended MITTS: Euro/Pacific 11, S&P 500 or Nikkei 225 MITTS. All of these securities pay back the original \$10 plus 100% of the percentage increase in the individual indexes they track at maturity.

But Why Japanese MITTS Today?

After a decade of brutality, harsh reforms may finally right the ship in Japan — and even if they don't, we'll still get paid.

The Nikkei 225, Japan's benchmark index, is the equivalent of our S&P 500. But after being revamped in 2001, the Nikkei 225 now is almost one-third technology and better reflects the Japanese economy.

When the Nikkei 225 MITTS (AMEX: MNK) maturing on 3/30/09, was issued, the Nikkei was at 11,261. Since then, it has dropped to around 10,207. That's about half of where it was three years ago and about 25% of its value a decade ago.

So is Japan's economy likely to regroup before March 30, 2009 — MNK's maturity date? It's possible. Consider that the U.S. market had risen 19% a year for over a decade, prior to the recent correction and subsequent mirrarily. And despite the horrendous bear market in Tokyo over the same period, the Nikkei's rallied more than 17% year-to-date (as we write). And there are many other reasons to believe that Japanese stocks will continue to pick up over the next few years. Here are a few:

- The Japanese economic contraction appears to have bottomed.
- Japanese stocks are cheap relative to U.S. stocks. Unlike the S&P 500, which sells at more than five times book value, the Nikkei 225 sells for only about two times book.
- The banking system in Japan, a big part of the economic malaise in the '90s, is being cleaned up (ever so slowly).
- Market sentiment is becoming positive for the first time in a very long time. Still though, stocks remain greatly unloved by individual investors.
- International money managers have beaten their benchmark global index over the past several years by doing one thing: by consistently being "underweight" Japan. Now they don't own much there. But now that it appears the bull train is leaving the station, these same money managers may soon be climbing on top of each other to jump on board. If Japan's markets continue in the right direction, a lack of exposure to Japan would mean the managers' pension and mutual funds would begin to underperform their benchmark. Count on these guys acting to keep their jobs if the upward trend continues.
- Finally, Japan is the least correlated major market to the U.S. in the world. While Europe will tank if the U.S. tanks, more than any other major country, Japan marches to the beat of its own drummer.

Nobel Prize-winning free-market economist Milton Friedman has been making bullish comments about the Japanese economy as well — he's said that it would be foolish for U.S. investors to underestimate the education, wealth and adaptability of the Japanese people. The market has been telling the Japanese that their system is no longer

competitive in the world economy. High taxes and tariffs, lax banking standards, and cozy relationships between government and industry will eventually go the way of the dodo. Anyone who thinks the Japanese lack the will to make these kinds of changes need only look back at Japan's response to the devastation suffered in WWII.

But the best part is this: Even if the naysayers on Japan are right and it doesn't recover, with MITTS investments, your only risk is opportunity cost. If the Japanese stock market gives back the ground it's gained this year or worse, completely tanks again, you still get your entire principal back. If, in six years, Japanese stocks have not moved one iota, you'll take your original funds at risk home for \$10 per share. And if the Nikkei even recovers half of its former glory, you'll be along for the ride...all of it.

Zero downside, unlimited upside. That's what we strive for — and that's what MITTS investing is all about. Buy Japanese MITTS, and you'll know that you won't ever get burned.

The Profit Magician's Tricks Revealed

So exactly how does Merrill Lynch pull off this sleight-of-hand? Simple. When it brings these securities public, part of the proceeds go into a zero-coupon bond that guarantees the principal at maturity. The balance goes into a long-term index option that locks in the increase in the index over the life of the security.

Voila! Unlimited upside with zero downside risk. It's every investor's dream.

And once you own these three MITTS, you have really done something quite extraordinary. To begin with, you have positioned your portfolio to benefit from market appreciation in U.S. large-caps, Euro-Pacific stocks and Japanese stocks.

That's a wonderfully diversified global portfolio. And, despite the cautious optimism that currently reigns in many markets, as the world confirms that its economy is gradually getting back on its feet, the capital appreciation in these markets could be extraordinary.

Secondly, even if the direst predictions about future market performance come true (which we personally don't believe at all), it won't deflate your portfolio in the slightest. Merrill Lynch, the world's largest securities firm with \$2 trillion in client assets, guarantees you will receive no less than \$10 a share.

Bet You Can't Buy Just One MITTS — And Why Would You?

Buying the whole portfolio allows you to have your cake and eat it too. Let's say, for instance, the S&P 500 and European stocks go down, but Japanese stocks and U.S. small-caps go up. You get to keep all the profits from the bull markets, and you get your principal back in the markets with negative performance.

In short, you have built a fortress around your investment portfolio. One that no recession, no war, and no market crash can undo.

Even though owning these three securities will cost you about \$40 (as of February 2004), you cannot receive less than \$40 at maturity. Your worst-case scenario is a small profit. Your best-case scenario, depending on how much the markets appreciate from

here, is you make a heck of a lot of money.

Eliminate a Good Chunk of Uncertainty in Your Life

This portfolio takes all the fear and uncertainty that exists in the market right now...and eliminates it completely. Investors now have an investment portfolio that is well-diversified, rock-solid and fully insured against loss. The shortterm performance of the market is now completely irrelevant.

And, since stocks have always outperformed cash and bonds over longer periods, that puts time on your side.

This article was originally published as an Oxford Club Investors' Report, and more recently as a special report on [MITTS Investments](#) on the [InvestmentU.com](#) Web site. The Oxford Club, founded in 1984, has become the largest financial organization of its kind with over 65,000 members in over 110 countries. The Club helps investors around the world create a financial legacy for their families that is shielded from excessive taxation, seizure, fraud, and inflation. The Club supports limited government, free markets, and individual liberty. As part of its educational arm, the Oxford Club started InvestmentU over 6 years ago.

Copyright 2004, The Oxford Club, LLC, 105 W. Monument Street, Baltimore, MD 21201. Phone: 410.223.2643. All rights reserved. No part of this report may be reproduced or placed on any electronic medium without written permission from the publisher. Information contained herein is obtained from sources believed to be reliable, but its accuracy cannot be guaranteed.