



Stock Selection 101

A SMART INVESTOR'S GUIDE TO SUCCESS

LATTCO® SEARCH CRITERIA

Lattco uses many different factors and criteria to analyze, filter, and identify stocks appropriate for your account. The goal of Lattco is not to choose stocks that will go up (or down) in price; it is to find stocks that fit the parameters of your particular account and have the greatest potential of meeting the objectives established by the Snider Investment Method®.

The Snider Method has a specific risk/reward profile, so in many ways, selecting appropriate positions is a balancing act based on cost benefit analysis. Lattco uses screens to exclude stocks that don't fit within a specific framework. However, as the number of excluded stocks increases, the opportunity for higher option premiums decreases. Although managing risk is essential, it involves a trade-off of potential profit.

Some of the criteria Lattco uses are driven by market data, while others are based on the underlying philosophies of the Snider Method. Generally, each specific criterion falls into one of three categories: options, safety/stability, and account efficiency.

Options

Using options to generate income is an essential part of the Snider Method. Lattco only includes stocks that have exchange traded options available. Once Lattco identifies optionable stocks, it applies the following filters:

- **COVERED CALLS:** Buying a stock and selling a call (covered call) is the primary tool for income generation in the Snider Investment Method. Lattco scans all the available covered call combinations to recommend a new position for your account. All accounts need to begin in all cash. Lattco does not recommend calls for existing stock positions.
- **OPTION EXPIRATION:** This refers to the month option contracts expire. Lattco selects options that expire one month out. For example, if you use Lattco to get new positions on any day in March, the options it selects will expire in April. Lattco selects calls that are one month out because time decay is greatest as expiration approaches. All options recommended by Lattco expire on the third Friday of the following calendar month.
- **OPTION STRIKE PRICE:** Lattco selects call options that are one strike price out-of-the-money. Selling call options one strike out-of-the-money gives you the most premium, while still allowing you to make some profit the call is exercised.

The puts Lattco selects are 95% out-of-the-money. Selecting put strike prices that are a percentage out-of-the-money allows the Snider Method to establish a uniform level a stock must decline in order for the put to be assigned.

To ensure prompt, easy, and cost-effective execution of trades, Lattco selects options that are trading in a liquid market - one that has interested option buyers and sellers. The best measures of option liquidity are Option Volume and Open Interest.

- **OPTION VOLUME:** Option volume refers to the number of contracts traded each day. In an effort to sell options that are trading in an active option market, Lattco sets the minimum amount of acceptable average option volume at 100. Volume tends to reduce the spread between the bid price and the ask price and creates a more efficient market.
- **OPEN INTEREST:** Open interest refers to the number of option contracts traded on a particular stock that have been opened, but not closed or exercised. Lattco will not select a stock that has an average open interest less than 4,000. As the Monthly Purchase Level of shares increases, Lattco's minimum average open interest requirement also increases. Like option volume, a higher level of open interest reduces the spread between the bid and ask price.

| AVERAGE OPEN INTEREST | MAXIMUM PURCHASE LEVEL |
|-----------------------|------------------------|
| Less than \$75,000 | 100 |
| Less than \$150,000 | 200 |
| Less than \$300,000 | 300 |
| Less than \$400,000 | 400 |
| Greater than 400,000 | 500 |

Safety/Stability

One of the goals of the Snider Method is to own stock in companies that are financially sound. Lattco uses two screens to seek out stocks that have an increased level of safety and stability.

- **BANKRUPTCY SCREEN:** Anytime you're invested in the Stock Market, there is a risk that one of the companies in your portfolio could go bankrupt. Although this risk cannot be eliminated, the Snider Method deals with it by only investing in companies that pass a screening test designed to identify companies with higher risks of bankruptcy.

Currently, Lattco uses RapidRatings' Core Health Score (CHS) to screen for bankruptcy and exclude stocks deemed to have a higher propensity for bankruptcy. RapidRatings is the only unbiased, purely quantitative financial health system. The CHS is a single number from 0-100 that indicates the overall financial health of a given company at a glance. Utilizing only the financial statements it calculates 62 efficiency and stability ratios across 24 industry models to assess how effectively a firm uses its resources.

- **SIM SCORE:** The SIM Score measures price volatility over a multi-year period. Its function in the screening process is to remove the most volatile stocks from the pool of possible investments. This screen was added to Lattco in an effort to reduce the number of positions that experienced a significant drop in price and/or prolonged periods where options cannot be sold (winter).

Account Efficiency

Lattco uses several pieces of information to select positions that are appropriate for your particular account.

- **UNALLOCATED CASH:** Lattco uses your account's available cash, which is the difference between your Stake and your Allocated Cash to find new positions. The minimum available cash needed to support a new position is \$12,500 in a margin account and \$17,500 in a non-margin account.
- **STOCK PRICE RANGE:** Lattco determines a lower and upper limit of price for the stocks it will select. The lower limit of price is \$25 for all accounts. Lattco selects stocks trading at a minimum of \$25 because higher priced stocks tend to generate more option premium and are capable of accommodating a larger decline in stock price. Although you would continue to trade a stock if it dropped below \$25, you will never start with one.

The upper limit of stock price (ULSP) is calculated using the Stake, Allocated Cash, and margin requirements of your account. It will not select a stock priced higher than the upper limit. The upper limit of stock price controls the size of an individual position in your account. It is also the maximum you will spend on a position in the first month.

ETF Portfolio (Margin below \$35,000 & Non-margin below \$56,000):

$$\text{ULSP} = \text{Stake} / (\text{Divisor} * 100)$$

Category 2 (Margin below \$300,000 & Non-margin below \$400,000):

$$\text{ULSP} = \$60$$

Category 3 (Margin greater than \$300,000 & Non-margin greater \$400,000):

$$\text{ULSP} = (\text{Stake} * 10\%) / (\text{Divisor} * 100)$$

- **ADJUSTMENT FACTOR:** Because larger accounts are able to hold more positions, the odds that every position will use all of their Allocated Cash are small. To take advantage of this, Lattco uses an Adjustment Factor in accounts that have a Stake greater than \$500,000. The Stake is multiplied by an Adjustment Factor, which may enable you to hold a few additional positions in your account. The table below shows you the Adjustment Factors for different account sizes and types:

| ACCOUNT SIZE | MARGIN | NON-MARGIN |
|-----------------------|--------|------------|
| Less than \$500,000 | 100% | 100% |
| Less than \$750,000 | 102% | 105% |
| Less than \$1,000,000 | 104% | 110% |
| Less than \$1,500,000 | 106% | 115% |
| Less than \$2,000,000 | 108% | 120% |
| More than \$2,000,000 | 110% | 125% |

Lattco monitors the available cash in your account and if necessary, the adjustment factor will be scaled down to avoid possible over-allocation.

- **SECTOR DIVERSIFICATION:** To diversify your Snider Method portfolio, Lattco tracks the open positions you have in all of your Snider Method accounts and applies an allocation limit to determine the maximum amount of cash you can have allocated to any particular sector.

Currently, Lattco uses ten sectors: Basic Materials, Conglomerates, Consumer Goods, Financial, Services, Healthcare, Industrials Goods, Technology, Utilities, and Unclassified, which includes diversified ETFs and companies that do not fall within one of the other classifications.

The allocation limit varies by the size of your account. It is 30% in larger accounts (margin accounts with a Stake above \$100,000 and non-margin accounts with a Stake above \$160,000). The allocation limit increases in smaller accounts because they hold fewer positions. Once a particular sector reaches the allocation limit, Lattco will not select new positions within that sector.

- **INDUSTRY DIVERSIFICATION:** To further diversify your account, Lattco tracks the industry of new and open positions. A stock's industry is a deeper explanation of the company's business. There are over 150 different industry classifications. Lattco will limit an account to one company per industry until an account reaches a significant size.
- **ETF PORTFOLIO:** Margin accounts with a Stake below \$35,000 and non-margin accounts with a Stake below \$56,000 only are categorized as ETF portfolios. To add diversification to these accounts, Lattco will only recommend an ETF. An ETF (Exchange-Traded Fund) is a security that trades like a stock, but tracks the performance of a basket of stocks or commodities. Although using an ETF should reduce the risk in smaller accounts, it will likely reduce the yield as well, but Snider Advisors believes this tradeoff is beneficial for clients with smaller accounts.
- **SORTING THE RESULTS:** Lattco uses Percent Downside Protection and Dividend Yield to determine which of the stocks that are passed through the previously listed filters will ultimately make it on your list of new positions:
 - ✓ Percent downside protection is a representation of the call option premium as a percentage of the stock's price. We use percent downside because it allows for the maximum potential of call income per dollar of allocated cash spent.
 - ✓ Dividend yield is added to the income estimation when sorting results. One quarter of the annual dividend yield will be added to the percent downside protection to give preferential treatment to stocks that pay regular dividends.

The Fine Print

The intent of this document is to help expand your financial education. Although the information included may be relevant to your particular situation, it is not meant to be personalized advice. When it comes to investing, insurance, and financial planning, it is important to speak to a professional and get advice that is tailored to your unique, individual situation. All investments involve risk including possible loss of principal. Investment objectives, risks, and other information are contained in the Snider Investment Method Owner's Manual; read and consider them carefully before investing. More information can be found on our website or by calling 1-888-6-SNIDER. Past performance is not indicative of future results.

Options involve risks and are not suitable for all investors. Before opening an option position, a person must receive a copy of Characteristics and Risks of Standardized Options. Copies of this document are available by calling 888-6-SNIDER. Please read it carefully before investing.