

Small-Cap Value Team

Although small-cap stocks are inherently volatile and the sector itself rather inefficient, sector investment returns have historically fared well over time against the major market averages. The portfolio management team of *The Munder Small-Cap Value Fund*, no strangers to the risks and rewards of the small-cap sector, handily make the case for investing in small-cap value stocks with *TICKER*.

Q: *The Fund is managed by a team, can you describe team members?*

A: The Munder Small-Cap Value Fund adheres to a team-based management approach. However, each of the three portfolio managers — Robert E. Crosby, CFA; Julie R. Hollinshead, CFA; and John P. Richardson, CFA — are recognized for their investment expertise in certain sectors, the result of their diverse backgrounds, and accordingly take the lead in analyzing potential investment opportunities in companies that hail from their particular areas of specialization. Crosby, for example, has energy sector and REIT fund experience, Hollinshead has covered the consumer staples and retail sectors, and Richardson has a strong finance sector background.

Q: *What is your small-cap investing philosophy?*

A: Investing in the small-cap arena requires a readiness and commitment to conduct extensive research, adhere to a disciplined investment approach, and not least of all, the "stomach" to withstand the sector's inherent volatility. The small-cap segment of the market can be rather inefficient, and only well-

prepared investors will have the confidence required to invest during such times. Our investment approach is based on in-depth company evaluations on, among other criteria, the return on invested capital and consistent profitability. This patient and disciplined approach can deliver return to the investor while also mitigating some of the volatility.

Q: *How do you put this investment philosophy in practice?*

A: The first step is to identify strong management teams at companies that are selling at reasonable prices. One of the best measures of whether the company is well-managed is the return on invested capital. We do not look for turnarounds, nor deep value, and are not asset players. We do not place much emphasis on the Street's consensus estimates and prefer to follow our own proprietary research and investment goals, rather than try to guess where the market is heading and what other people may be doing with their capital or in this space.

Our initial investment ideas come from proprietary screening, but we'll rarely buy a stock without having met the management. We adhere to a bottom-up

Fund Facts

Symbol	MNVAX
Website	www.munder.com
Address	Munder Capital Management 480 Pierce Street Birmingham, MI 48009-6059
Tel. No.	800-468-6337
Inception	01/10/97

Portfolio

Total Net Assets *	\$ 79.10
Avg Mkt Cap (\$ Weighted) *	\$ 1,370
Average Price/Earnings Ratio	16.80
Average Price/Book Ratio	1.90
Turnover Ratio	43 %

Investment Information

New Investment	Open
Min Initial Investment	\$2,500
Min Subsequent Investment	\$50
Min Initial IRA Investment	\$500

Risk (Against S&P 500 - 3 Years)

Alpha	16.41
Beta	1.02
R-Squared	54.12
Ann Std Deviation	19.68
Sharpe Ratio	0.69

Returns vs. Lipper Small-Cap Core Median

	MNVAX	Index
1 Year (Cum.)	31.06 %	19.74 %
3 Year (Ann.)	14.99 %	6.96 %
5 Year (Ann.)	14.43 %	8.94 %

Returns vs. S&P 500

	MNVAX	Index
1 Year (Cum.)	31.06 %	13.17 %
3 Year (Ann.)	14.99 %	-1.48 %
5 Year (Ann.)	14.43 %	-2.24 %

Fees and Expenses

Max Sales Charge - Front	5.50 %
Max Sales Charge - Deferred	0.00 %
Max Redemption Fee	0.00 %
Total Expense Ratio	1.38 %

Portfolio Manager

Team Managed	
* millions	Data through: 7/31/04
Source: Company Documents; Lipper	



stock-picking approach, which means we look at a company's filings to understand its historical performance, its fundamentals, and its management philosophy, all of which ultimately helps us discern how the company got to where it is today. Perhaps as a result of such familiarity, we are comfortable holding a good stock through rough patches. If some external factor should drive the stock down, our knowledge of the company and its leadership will frequently help keep such stock movements in perspective. Indeed, while others are selling, we may very well be buying.

Munder Capital has considerable risk controls in place to ensure we do not venture from the fund's promised investment style, criteria and objectives. The Munder Small-Cap Value Fund typically holds approximately 100 names, which are held, on average, for three years. While the average market cap is \$900 million, we will look at companies as small as \$125 million but no larger than \$1.6 billion. More specifically, we benchmark to the Russell 2000 Value index, have a maximum tracking error of 7%, and keep individual stock weights down to less than 2.5%. It is also worth noting that we also have sector constraints based on the index weights. Clearly, diversification is key to managing risk, particularly in a volatile sector like small-caps.

Q: *What is your buy discipline?*

A: For initial purchases, we look at companies under a market cap of \$1.6 billion, as that is the ceiling placed on small-cap for the Russell 2000 Value index we benchmark against. In terms of the bottom of the range, that is determined mostly on liquidity concerns. In terms of valuation, we focus on trailing enterprise value to earnings before taxes, depreciation and amortization (EBTDA) on a four-quarter basis. We are skeptical of any company with frequent write-offs.

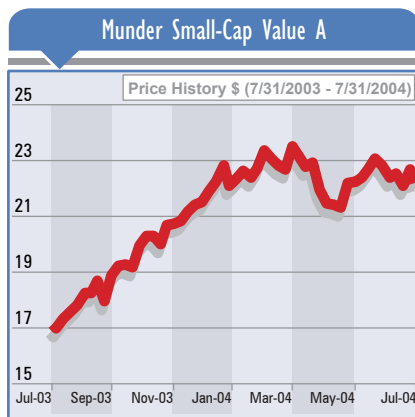
Q: *What is your sell discipline?*

A: Regardless of how well a stock has performed, we will look to reduce our holdings if it appreciated to where it is approaching 2.5% of the fund. As a value

manager, we like to trim the stock, and sell the position only if the fundamentals have changed. We draw a distinction between external and internal misses. For example, we will sell the stock if we lose confidence in internal execution, such as missed targets, where there's an apparent lack of controls, or if we lose confidence in management.

There are times when we sell the stock on valuation concerns — where we cannot justify it or we have more appealing alternatives. We will generally hold a stock for three years, evaluating it on a quarterly basis.

Q: *One requires intensive research to succeed in the small-cap market. How do you build this advantage?*



A: As indicated earlier, we start with proprietary screening to identify profitable companies we may want to include in the portfolio. Once we have a preliminary measure, we will then drill down deeper for a more comprehensive understanding of the companies in question. Our research includes conversations with management, as well as in-house and external research. If there is no analyst following a company we are interested in, we simply compile the data ourselves, following a bottom-up approach. We place a lot of emphasis on our own proprietary research and do not mind if there is no Wall Street coverage on a stock.

Q: *What is your screening process?*

A: As mentioned earlier, fundamental screening is very important, but it is only one part of the stock selection

process, particularly if you adhere to a bottom-up approach like we do.

To simplify a complex process, we look at a number of financial measures in our screening. We typically look for companies that are two- to three-times more profitable than average, but are trading at lower-than-average valuation. The fundamental question that we always have to answer, of course, is "Why is this profitable company trading at a discount?" We strive to find the answer through our qualitative analytical process. Frequently, the answer lies somewhere in perceived earnings, cyclical-ity, interest rate risk or market conditions.

We look at P/E and return on invested capital [ROIC], but our primary measure of value is enterprise value to EBTDA. We look for above-average profitability and historical consistency across quarterly earnings. As a result, we tend to find more opportunities in the consumer discretionary, finance, selected industrials and healthcare arenas. It is more challenging to find utilities, materials, and technology companies that fall within our parameters, though we always find some.

Q: *Do you find meeting management helpful?*

A: Absolutely. We prefer to meet a company's management team before making an initial investment whenever possible. Meetings lead to a greater understanding of the business model, profitability, market opportunities, and potential challenges. It also helps to better gauge whether management's interests are ultimately aligned with those of the investors.

Q: *Can you give examples of two stock picks that have not worked? What have you learned from these experiences?*

A: Two come to mind: United Online [Nasdaq:UNTD] and Insituform Technologies [NASDAQ:INSU].

We initially believed that the dial-up Internet access provider United Online had a loyal customer base and predictable earnings. Even in the midst of the market's shift to broadband access, we remained confident that its user-base would stick with the company, thinking

that it enjoyed a loyal and stable customer base. They operate at the lower end of the market, where you find the so-called "delayed adopters." The company had been enjoying good growth rates and, because customers were price-sensitive, we did not foresee them moving to broadband providers. But we found that every quarter its cost of acquiring new customers was rising and it had to resort to several promotions to retain, much less acquire, customers. With the customer acquisition costs perpetually rising, we eventually exited the stock. In the case of UNTD, we certainly learned that some services are more commodity-like than they may first appear, giving them less of a competitive advantage.

Another example is Insituform Technologies, which specializes in laying underwater tunnels for sewage and wastewater. On paper, everything certainly looked compelling: the company had expanding margins and offered attractive fundamentals. As well, through our meeting with management, we learned that the company enjoyed certain competitive advantages over its peers in laying underground pipeline, and that there is secular growth in replacing sewage lines and other large wastewater tunnels. While both were seen as growth drivers, INSU simply did not receive the number of customer mandates that we had anticipated, and certainly not at the pricing we had expected, thanks to competitive pressures. We exited the stock in light of the internal misses.

Q: *Can you share some of your successes in stock picking?*

A: Homebuilders have been out of favor with investors. Rising interest rates and the expected slowdown in home mortgage originations have kept the stock valuation of the builders in check. However, one of the better-managed homebuilders, Pulte Homes [NYSE:PHM], met our criteria of earnings growth and profitability. Having initially invested in Pulte in 1999, we continued to build our position during the last three years, despite the market's general skepticism toward its prospects and that of the broader sector.

We found the management team to be on the cutting-edge of the industry and we were attracted to its approach in managing the business, particularly with regard to their ability to consistently grow earnings. The returns our investments have generated are rewards for our research and our understanding of the home building sector.

Another example is Newcastle Investment Corp. [NYSE: NCT], which originates and manages commercial mortgage-backed securities. The company is structured as a REIT and its prospects are viewed to be interest rate sensitive, even though the company hedges all its interest rate exposure. The market has a skeptical view of its growth prospects. Here is a

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about

**Robert E. Crosby,
Julie Hollinshead,
John P. Richardson**

Robert Crosby, CFA, is a senior portfolio manager with Munder Capital Management. He has 11 years of investment experience and manages the Munder Real Estate Equity Investment Fund in addition to institutional client assets.

Julie Hollinshead, CFA, is also a senior portfolio manager with over 20 years of financial service industry experience and 11 years of investment experience. She has been working with the small-cap value process since 2001 and is a co-manager of the Munder Micro-Cap Equity Fund.

John Richardson, CFA, is one of the founding members of Munder Capital Management with over 29 years of investment experience. He also co-manages the Munder Micro-Cap Equity Fund in addition to managing institutional client assets.

company that will grow at 15% this year and next, and has a dividend yield of 8.5%. ROE has been 17% plus. This sector suffered heavy selling in April 2004 and the stock came down significantly. We were comfortable with the financial results of the company and used this period of weakness to add to our holdings. Investing in this company is a credit play, and as the economy recovers, we believe that the stock will benefit.

Q: *What risk controls have you put in place?*

A: There are a number of risk management protocols in place. We monitor the tracking error to ensure we stay below 7%, and our sector weights are monitored daily and weekly. And, as we are benchmarked to the Russell 2000 Value, we can only go plus or minus 4% to the benchmark sectors, which helps mitigate risk. It's worth noting that we do not underweight a sector more than 4%, even in sectors that we do not like. We are very vigilant about delivering the investment product that our investors have invested in — a small-cap value fund — meaning we buy companies below \$1.6 billion in capitalization and trim when necessary. As well, we constantly measure weighted capitalization and do not deviate more than 25% plus or minus for the market cap. Further, we spread our investments among 100 stocks so we have a low company-specific risk.

Q: *Why do you think you have succeeded where others have found challenges in small-cap sector investing?*

A: Our bottom-up approach, strong risk management protocols, and investment returns for doing our research "homework" give us the confidence necessary to continue in such a volatile sector. Small-cap value may be a "lonely" sector, but not one without reward. Since there's less competition, there's less information flow and less efficiency being offered to investors. That creates a huge opportunity for proficient teams like ours to offer a very compelling investment vehicle. ■

TICKER Staff