

The Inflection Point



In response to customer demand, American Century opened its New Opportunities Fund II in June 2001. As of February 3, the new fund became a load fund and is available to investors only through financial professionals. Ticker spoke with co-manager John D. Seitzer about the fund's unique investment approach.

Q: Does the fund's investment style still reflect the views of American Century's founder, James Stowers?

A: For the New Opportunities Fund II we use the same style that was used when the founder started the company more than 40 years ago. He founded the company on the principle that money follows earnings in the stock market. To look at it more practically, he focused on accelerating earnings and revenues. You can think about it as we're looking for companies that are showing an inflection point in their business fundamentals. Some type of catalyst might be driving that. Then we're looking for sustainability on that improvement. Unlike traditional growth mutual fund managers, we don't use some type of artificial threshold for a growth rate. So we're not screening for companies that are growing faster than 20% a year, or anything like that. Instead, we're looking for companies showing improving growth rates. Also, another unique aspect of it is to say that companies that will clear our screen could actually be showing a decline in their revenues. But that decline could be less negative compared to the prior quarter. As an example, last quarter the revenues could have declined 20% and this quarter they are down 15%, year-over-year. That would be an improvement to us. That would be a sign that business is actually getting better.

Q: We know that 1999 was a dramatic year on the incline and that 2000 was equally dramatic on the decline. Lately, the rate of decline

has decelerated. What is your view for the small cap sector?

A: If you look at the direction of the market in just our small cap growth category, I would say our fund is still fairly defensively positioned. We aren't seeing a large prevalence of acceleration just yet in the economy and its different sectors. It's getting a little better, but the economy isn't rallying back strongly at this point yet.

Q: It is my understanding that small companies tend to do better when the U.S. economy is coming out of a recession.

A: That's accurate. One of our views on the world is we feel that the consumer, typically in a recessionary time, will be first to turn down and the first to turn back on their spending. This go-around, the consumer was somewhat incentivised throughout the whole downturn to keep on spending. We don't have that pent up consumer demand coming out of this recession. We're going to see a big bump in consumer spending, which is somewhat needed to drive business spending. I don't think there is a lot of room there for that big bump in spending to drive things.

Q: Even in recessionary periods, there are always small companies that do well.

A: That's very true. We've had a few that worked out pretty well. Particularly in this universe, you can find these companies. Our process is driven by a bottom up approach of

American Century New Opportunities II Inv		
Fund Facts		
Symbol	ANOIX	
Website	www.americancentury.com	
Address	American Century Investments, 4500 Main Street P.O. Box 419200, Kansas City, MO 64141-6200	
Tel. No.	800-345-2021	
Inception	06/01/01	
Portfolio		
Total Net Assets *	\$25.80	
Avg Mkt Cap (\$ Weighted) *	\$989.00	
Average Price/Earnings Ratio	29.71	
Average Price/Book Ratio	3.78	
Turnover Ratio	54.00%	
Investment Information		
New Investment	Open	
Min Initial Investment	\$10,000	
Min Subsequent Investment	\$0	
Min Initial IRA Investment	\$10,000	
Risk (Against Std Index - 3-yr Average)		
	ANOIX	Category Avg.
Alpha	---	4.78
Beta	---	1.07
Returns vs. Lipper Small-Cap Growth Index		
	ANOIX	Index
1 Year (Cum.)	-17.00%	-27.34%
3 Year (Ann.)	---	-17.16%
5 Year (Ann.)	---	-1.45%
Returns vs. S&P 500		
	ANOIX	Index
1 Year (Cum.)	-17.00%	-23.02%
3 Year (Ann.)	---	-13.84%
5 Year (Ann.)	---	-1.33%
Fees and Expenses		
Max Sales Charge - Front	0.00%	
Max Sales Charge - Deferred	0.00%	
Redemption Fee	0.00%	
Total Expense Ratio	---	
Portfolio Manager		
Management Team	---	
* millions	Data through: 01/31/03	
Source: Company Documents; Lipper		

identifying these companies that are showing signs of acceleration and then doing research to investigate them further. The process initially starts out with a screen that is done using our proprietary database.

Q: Then you do use proprietary software?

A: It's something we've done since the company was founded. Historically, prior to computers, Mr. Stowers used his calculator. I can't remember how many he said he wore out doing this, but he would actually calculate all this data manually and write the numbers on paper. Once computers came around, he sat down with IBM and worked out a program that fit his thinking and his practices. One feature that has been a big benefit beyond revenues and earnings acceleration is we have added to our database many other industry specific metrics. For example, in the airline industry you might see a turn in revenue passenger miles, or available seat miles, or load factors that all companies typically report. You might see those inflect before the numbers actually show up in the earnings. Our whole process is driven by moving on things at the crack of the bat - when you see that inflection point. We want to catch that first metric that turns so that we're early in the stock price move.

Q: So, in your view there is a difference between buying low and buying early?

A: That's right. We definitely look for tangible evidence before we'll buy something. We'll not buy ahead of an earnings report, even if Wall Street is out there saying it's going to be good, trust us, the numbers are going to come through. We want to be able to point to something that's already showing improvement.

Q: You're saying that you don't necessarily pay attention to the wirehouse research.

A: No. Even though our universe is fairly large, we have sufficient idea generation capability in house. The other thing, too, is a lot of times Wall Street is driven by different things than we are, so they don't necessarily know how to communicate their ideas that fit our parameters.

Q: American Century has always taken a team management

universe of stocks such that if you were a technology analyst and technology was out of favor, you'd still try to sell your wares somehow to make yourself useful. You're still trying to pitch the best technology stocks in your group. But it may just be that we don't want to own any technology. Or, we'd want to own a lot of technology and no chemical companies.

Q: Do you pay a lot of attention to operating cash flow?



approach. How many members comprise the team for this fund?

A: Currently there are five team members, two portfolio managers and three analysts. All the members of the team are generalists, so we don't necessarily have a utilities analyst or a technology analyst. Everyone gets their feet wet in a lot of different areas.

Q: So you have a lot of people who are innately interested in a lot of different things.

A: I like the process because it gives the portfolio managers and the analysts a perspective on the entire economy and the

A: We do more and more of it, I would say. We don't track it specifically, but if we know a company to be particularly debt laden, then we will definitely look at their cash flow generation capability.

Q: What is the market capitalization range of the companies that you screen for inclusion into the fund?

A: Our screen is roughly \$100 million worth of market cap up to \$8 billion, but I'd say there's a sweet spot between \$500 million to \$3 billion where we typically fish. We do get thrown into a small cap class known as the "smid cap" growth category due to our somewhat unique

growth style. We try to go as small as we can, but we're constrained, based on the liquidity of the stock. We try to keep an eye on that and won't take a position beyond a week's trading volume.

Q: Some market observers feel that technology may not begin growing significantly for at least a couple more years. But there are other promising sectors. What is your research process revealing to you?

A: Some of the areas that our processes have drawn us to would include healthcare and industrials. Healthcare, beyond the long-term demographics that indicate increased spending there, we're seeing some individual companies in our universe that have compelling stories currently, where they're showing acceleration. A couple would be Accredo Health and Fisher Scientific.

Q: How closely do you monitor these companies?

A: We do attend conferences. Typically, our conversations with management are over the phone. A lot of times they will come through Kansas City and stop off here to meet with us. We never go to a company. A universe of our size, that's just too time intensive to try to go see companies on their turf. When we do the initial research on a company, the process would be a company clears our screening process when they report their quarterly earnings. Then we'll take a closer look at it to see what's driving the change in the numbers they reported, that inflection point. Then we will determine whether that's sustainable and what the risks are. To assess all that, we'll listen to the quarterly conferences, for sure, and in many cases, we'll follow with a call to the management team and talk to them further about some of the more in depth questions that we have. If they're reporting good numbers

we often times won't call them for several months. But if there is some blip in the stock price, or we identify some related story that might impact them, we'll call them to ask what are the implications for the company based on this news item that we saw.

something that would be consistent across the holdings.

Q: Do you pay attention to stock charts in determining buy/sell decisions?

A: We definitely do. Many times there's information con-

A: We watch it very closely. It's been very prevalent over the last 12 months among companies that what they'll do is book a restructuring charge. That's not a GAAP accounting charge. That's just something where they say, hey, we're going to carve out these expenses and say they're

acceleration. It's being driven on some artificial charge that they're backing out. When the stock option thing surfaced, the pension accounting thing surfaced, we looked at every company in our portfolio and we looked at the footnote associated with the pension expense to figure out

“Our whole process is driven by moving on things at the crack of the bat - when you see that inflection point. We want to catch that first metric that turns so that we're early in the stock price move.”

Q: Aside from accelerating revenues and earnings, are there other characteristics shared by the companies that interest you for inclusion into the portfolio?

A: Starting with the primary questions that we ask of prospective holdings, and those being what's driving the rate of change, what's driving that inflection point, the second thing being whether it is sustainable, the third thing being what are the risks. The questions that are a layer down from that involve the competitive advantages of the company. We're looking for companies that have good staying power, that have some value added aspect that they're offering to their customers that's not transitory. I would say that a sustainable value added would be

present in a stock chart. You might say, well, it's just a stock chart driven by motion. But in a lot of cases there is something that causes an inflection point. We use charts pretty extensively when we ask ourselves what are the risks to this company. We'll pull out a ten-year chart on that company and see that five years ago the stock gapped down. That might be telling us there's some risk to this company. We'll use the history of that stock chart to indicate to us how we need to check out the fundamentals to determine what drove that, either gap up or gap down, because it could happen again.

Q: Quality of earnings has become an issue that is being watched more closely. How do you handle this issue?

non-operating so you guys just ignore that. Essentially, what they're doing is a catch up on expenses they should have been booking up to that point or they're pre-expensing what they should be booking going forward. I'll identify situations like that when we're doing research on a company and say, hey, the acceleration here isn't really high-quality

the assumptions for returns for the pension assets to see if they were too high and the sensitivity to the changes in those assumptions. We definitely pay attention to that stuff because it's important these days.

John Seitzer

John Seitzer is a vice president and portfolio manager for Kansas City-based American Century. He has worked in the financial industry since 1993. Formerly, he was a senior tax analyst with KPMG Peat Marwick in Kansas City. He holds a bachelor's degree in accounting and finance from Kansas State University and a master's degree in business administration from Indiana University. Seitzer is both a Chartered Financial Analyst and a Certified Public Accountant.

Dave Jennings ■