A Smooth Small-Cap Ride

Consistency and efficiency are key words in the strategy of the STI Classic Small Cap Growth Stock Fund. Its management doesn't like taking huge bets on individual sectors and stocks and the respective volatility. Instead, the Fund spreads the risk across a wide universe of sectors and more than 200 stocks. A clearly defined investment process aids the search for dependable results.

Q: *Would you describe your investment philosophy?*

A: Our philosophy is founded on three pillars: earnings and earnings growth, risk control through diversification, and stock selection as the driver of excess performance. In terms of earnings, we're looking for companies with accelerating and sustainable momentum in earnings and sales growth trends and the profitability trends, validated by strong fundamentals.

Risk control is a primary theme underlying our portfolio management philosophy to the point that the portfolio construction process is based on managing risk. We own a large number of stocks, roughly 200, taking equally-weighted initial position sizes of 0.5% to 0.6%. In addition, we implement controlled sector weightings, generated from our bottom-up stock selection. Our portfolio sector weights should not exceed more than two times the Russell 2000 growth sector benchmark weight, or a maximum of 35%.

This diversification leads us to a broad range of sectors and industries. We're not just searching for growth companies in traditional growth sectors. While some other growth managers may have huge weights in healthcare, technology, and/or business services, we tend to search for growth companies over a broader cross-section of the market.

One of the benefits of our philosophy is that it minimizes company-specific risk. In baseball terminology, our philosophy is about hitting singles and doubles, stealing bases, and manufacturing runs to generate excess performance, instead of swinging for the fences by taking big bets on individual stocks or sectors.

This strategy is designed to lower portfolio volatility, providing a smooth ride with dependable and consistent outperformance versus the benchmark. Lastly, this strategy enables us to be very agile in executing our discipline, which is another unique benefit. This is our ability to make crisp and effective decisions, based solely on the merits of the company and then to execute those decisions. Because we are taking smaller position sizes, we are able to build the positions quickly and, when the time comes, to sell those positions efficiently as well. Our portfolio structure enhances the decision-making process and the execution of our methodology.

Q: *What kind of earnings are you looking at? Are you emphasizing forward-looking earnings, historical earnings, or normalized earnings?*

STI Classic Small Cap Growth Stock Fund

Fund Facts

Symbol	SSCTX
Website	www.sticlassicfunds.com
Address	Trusco Capital Management 50 Hurt Plaza, Suite 1400 Atlanta, GA 30303
Tel. No.	800-428-6970
Inception	10/8/1998

Portfolio

Total Net Assets *	$ 1,270
Avg Mkt Cap ($ Weighted) *	$ 1,000
Average Price/Earnings Ratio	19.87
Average Price/Book Ratio	2.80
Turnover Ratio	100 %

Investment Information

New Investment	N/A
Min Initial Investment	N/A
Min Subsequent Investment	N/A
Min Initial IRA Investment	N/A

Risk (Against Russell 2000 Growth - 3 Years)

Alpha	0.26
Beta	0.90
R-Squared	0.94
Ann Std Deviation	4.72
Sharpe Ratio	1.41

Returns vs. Lipper Small-Cap Growth Class.

	SSCTX	Index
1 Year (Cum.)	21.15 %	18.57 %
3 Year (Ann.)	24.76 %	20.42 %
5 Year (Ann.)	6.09 %	-2.45 %

Returns vs. Russell 2000 Growth Index

	SSCTX	Index
1 Year (Cum.)	21.15 %	17.97 %
3 Year (Ann.)	24.76 %	23.23 %
5 Year (Ann.)	6.09 %	-2.54 %

Fees and Expenses

Max Sales Charge - Front	N/A
Max Sales Charge - Deferred	N/A
Max Redemption Fee	2.00 %
Total Expense Ratio	1.19 %

Portfolio Manager

Team Managed	

* *millions*

Data through: 09/30/05

Source: Company Documents; Lipper

Q&A TICKER's Choice

A: We look at a combination of factors, including earnings growth rates (both historical and projected), operating cash flow, earnings estimate revision trends, and the profitability metrics. We key on the direction and the momentum of each of these factors. We focus on companies that are typically profitable, either on an earnings or cash flow basis. Our goal is to identify companies that are in the early stages of a ramp-up in earnings growth rates that have not yet been fully reflected in the company's valuation.

Q: ***It is often difficult to rely on estimates in the small-cap area, because very few analysts follow those stocks. Estimates may be only one of the metrics you look at, but how do you handle this situation?***

A: If there are no estimates, we rely more heavily on our own internal modeling and analysis. The most extensive part of our analysis is our evaluation of the underlying fundamental trends. We uncover and evaluate the entire business model which may include all of the following: current business patterns and momentum (including sales growth trends, orders, bookings, or changes in deferred revenue); whether the growth is acquired or organic; the profitability model and potential operating leverage of the model, etc. Essentially, we are analyzing the momentum of the fundamental trends versus valuation for all our companies, but in particular where there are no "street" estimates. It comes down to our assessment as to whether the trajectory of a company's growth rate is reflected in the current valuation. Lastly, in the cases where there are a few estimates out there, we handicap the estimate, making our own internal assessment whether that number is achievable or not.

Q: ***How do you implement this philosophy into an investment process and strategy?***

A: When finding new stock ideas, we screen our universe, rank it, focus our fundamental research efforts on the top-ranked stocks within the universe, and make our decisions from this list.

First, we screen for companies that are under $2 billion in market cap with a maximum debt/total capital ratio of 75%. We also screen for companies that meet our requirements for trading liquidity. This screen helps us to narrow our universe down to about 2,000 stocks that we run through a proprietary multi-factor model.

The model is broken down into four distinct cells: earnings growth and momentum, estimate revision and expectations, price momentum, and valuation. The earnings cell comprises about 35% of the total model, estimate revisions 25%, price momentum 20%, and valuation accounts for the remaining 20%.

The ranking process is designed to help us identify stocks or companies with positive return characteristics. Based on our historical back-testing studies, the top-decile stocks have roughly a 70% chance of outperforming the universe, while the bottom-decile stocks have only 33% chance of outperforming the universe. It is pretty clear where we need to start our search for new ideas, and what stocks we should avoid. We focus on the top-ranked companies in our universe, before we narrow down this list and prioritize our top 30 or 40 stock ideas. These are the companies on which we focus our fundamental research efforts. This focus list of companies becomes our dynamic new idea list that updates on a weekly basis.

In the fundamental research process, our primary objective is to evaluate and understand the relationship between the most important variables that can influence the future earnings and the stock price of a company. The analyst team has to do three things. First, we analyze the financial fundamentals to ensure that we're looking at companies with strong balance sheets, high-quality earnings, solid profitability metrics, and positive momentum. Second, we want to uncover the company's business model, to understand the business dynamics, the competitive advantages driving the current trends, and the sustainability of those trends going forward.

Lastly, we try to focus on the most relevant pieces of information that can influence the fundamentals, earnings, or stock price of a company. This approach makes us somewhat unique because conventional wisdom says that you have to analyze and know every single piece of information about a company. This type of over-analysis does more to hinder than to help the decision-making process. We're more concerned about the key drivers, and we focus solely on those factors, as there is no need to uncover or analyze information that's not going to have an impact on the decision-making process.

Through this process, we engage the company management, but it is not a prerequisite to meet management before we buy a stock. Because we always strive to identify our companies at key turning points in momentum, we may have a fairly narrow window of opportunity to get in. If we like the company based on our initial analysis, we want to go ahead and take our research to the next level. It is at this stage of research that we make a determination of our level of conviction in the underlying business model, the strength of fundamental trends, and the sustainability of the future earnings growth.

Q: ***When you look at the earnings momentum, do you have a different approach for the various industries or a broader yardstick that works across industries?***

A: From a quantitative perspective, we have historically ranked each company against the entire universe, not against companies within their own sector. The efficacy of our model's overall selection has been very good over a long period of time. However, from a fundamental or qualitative perspective, we analyze a company's performance versus its competitors and other industry participants and try to assess how a company is performing versus its peers.

Q: ***What are the most important aspects of your sell discipline?***

A: Having a disciplined process to efficiently and effectively identify companies with strong business fundamentals is only half of the equation; the other half is knowing when to sell them. We are very disciplined in monitoring our portfolio for any companies with weakening earnings or business trends for our sell discipline.

There are several potential catalysts that trigger a trim or outright sell decision, the most obvious being a deterioration or negative inflection point in the fundamentals that attracted us to a company in the first place. We constantly monitor our companies for any yellow flags, including but not limited to peaking or slowing momentum in sales, earnings growth, or the profitability trends. Another area of focus is estimate revision trends and earning surprises. Any moderation in these metrics potentially signal street expectations are catching up to a company's story. Similarly, if a stock's valuation reaches extreme levels relative to the underlying fundamental trends, then that could trigger a sell decision. And lastly, when a company reaches $3 billion in market cap we begin to implement an exit strategy. The alacrity with which we exit a name depends upon the strength of current fundamental momentum in relation to valuation.

Q: ***What are the turnover levels of your fund?***

A: Our turnover has been very consistent in the 90% to 110% range over seven years. This consistency is highly attributable to the consistency with which we have executed our process, which is one of the keys to our success. Roughly 75% of our turnover is stock in and stock out of the portfolio, whereas the remaining 25% is trading around existing positions. If the valuation of a company has gotten ahead of itself, but we still like the underlying fundamental trends, we may not want to sell the entire position. Instead, we may cut down the position and look for an opportunity to add back to it at a later date.

Q: ***In addition to having a diversified portfolio, what other risk control measures do you have in place and what risks do you perceive?***

"We are very fond of all our companies and we like to date them, but we don't want to marry them. It is much easier to part ways if and when the time comes."

about **Mark Garfinkel**

Mark D. Garfinkel, CFA, has served as Managing Director of Trusco Capital Management since 1994. He has managed the STI Classic Small Cap Growth Stock Fund since it began operating in October 1998. He has more than 18 years of investment experience.

Upon joining Trusco in 1994, Mark served as a Portfolio Manager for the firm's large cap core growth discipline. In 1998, Mark was selected to design and lead the firm's Small Cap Growth discipline. Mark is a member of the Atlanta Society of Financial Analysts and Chartered Financial Analyst Institute, (CFA charter holder in 1993), and earned his B.A. (1986) and M.B.A. (1987) from Vanderbilt University.

A: One of our primary objectives is reducing company-specific risk in our portfolio, but we also like to minimize the risk of getting too attached to a company. We are very fond of all our companies and we like to date them, but we don't want to marry them. It is much easier to part ways if and when the time comes. That means taking an arms-length approach towards communication with company management and towards the potentially biased assessments of sell-side analysts. We try to make our assessment based on the facts and not based on whether we really like a particular CEO.

In monitoring our portfolio risks, we track on a regular basis the Modern Portfolio Theory risk statistics such as standard deviation of the returns, the beta of the portfolio, our tracking error, and our sector weights relative to the benchmark. Even though our sector weightings are generated from our bottom-up stock selection, not only do we make certain that we stay within our sector weight guidelines, but we are always performing a check to make certain that an overweight or an underweight position in a particular sector makes sense from a big picture vantage.

We are not paid to manage market risk or hold cash as a proxy for stocks. Our investors expect us to be managing a small cap growth stock portfolio as a part of an overall asset allocation strategy.

Regarding management risks, our fundamental research includes an evaluation of the management decisions, company history, and capital allocation decisions, all of which is a reflection of the management and their decision-making ability at running the business. For example, we evaluate the impact of capital allocation decisions, such as major acquisitions or share repurchase, on stock price performance. One such study that we read evaluated every company, which has acquired a company that is at least 50% of its size, and found out that 70% of those companies underperformed over the next 12 months. These incremental factors help us to evaluate management decisions and play a role in our overall evaluation of company fundamentals. ▮

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