

Lead by Acceleration and Price Momentum

The great thing about growth stocks is that they can tremendously outperform the market for a period of time. The problem is that this window of opportunity, when the earnings grow recognized and appreciated by the market, is usually rather brief. That's why the American Century Heritage Fund stresses the effectiveness of monitoring and identifying the areas of the market where fundamental acceleration and relative strength in pricing occur together.

Q: What is your money management philosophy?

A: We believe that accelerating earnings and revenue growth, combined with improving relative stock price performance, should lead to outperformance over time. We search for evidence of improving business fundamentals as opposed to speculation of improvement.

Acceleration combined with relative strength will tend to perform best in markets that are trending, and not quite as well in choppy, directionless, rotational markets where stocks move for a short period, then roll right back over.

We invest where the acceleration leads us as opposed to what a certain benchmark is telling us. So depending on the market environment, the portfolio may appear more growth or value oriented, with higher or lower beta. It really depends on where the market is

leading us at any point in time. But we tend to reside on the growth side of the style box.

I believe we have a competitive edge because we're not benchmark-centric and we're willing to focus on companies traditionally deemed outside of the growth category. There aren't many other managers focused on their personally constructed benchmark as opposed to what the marketplace perceives as the proper benchmark.

Q: In the last five years there has been acceleration in the results of companies like Citibank, Wal-Mart, Target, Home Depot, and yet, many of these stocks haven't done well at all. What is your view on such cases?

A: That's where the importance of relative strength comes in. Our fundamental overlay focuses on the revenue

American Century Heritage

FUND FACTS

Symbol	TWHIX
Website	www.americancentury.com
Address	American Century Investment Management, Inc. 4500 Main Street Kansas City, MO 64111
Tel. No.	800-345-2021
Inception	11/10/1987

PORTFOLIO

Total Net Assets *	\$1,117
Avg Mkt Cap (\$ Weighted) *	\$10,300
Average Price/Earnings Ratio	32.91
Average Price/Book Ratio	5.36
Turnover Ratio	236%

INVESTMENT INFORMATION

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

RISK (AGAINST S&P 500 - 3 YEARS)

Alpha	0.14
Beta	1.42
R-Squared	0.63
Ann Std Deviation	13.6
Sharpe Ratio	1.12

RETURNS VS. RUSSELL MID-CAP GROWTH INDEX

	TWHIX	Index
1 Year (Cum.)	13.86%	13.04%
3 Year (Ann.)	15.34%	16.86%
5 Year (Ann.)	4.44%	4.76%

RETURNS VS. S&P 500

	TWHIX	Index
1 Year (Cum.)	13.86%	8.63%
3 Year (Ann.)	15.34%	11.22%
5 Year (Ann.)	4.44%	2.49%

FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	1.00%

PORTFOLIO MANAGER

Kurt Stalzer	Jan-2000
David Rose	Mar-2000

* millions

Data through: 6/30/2006

Source: Company Documents; Lipper



and earnings improvement; however, we're also focused on relative strength. I agree that sometimes you may have a very strong earnings and revenue accelerator, but the market may have no interest in the stock. Potentially, you may severely underperform during that time frame. Relative strength assists you in limiting this underperformance.

Q: Would you describe the investment process that identifies and researches these opportunities?

A: During earnings season, when a large number of companies report in a three-week period, we have a proprietary tool that allows a group of research analysts to effectively scour all the earnings releases within our market cap constraints. Within minutes of those companies reporting, the analysts will alert us to which companies have accelerated their earnings and revenues. We get a jump on what's actually accelerating before a lot of our competitors do.

Once we've determined that there is some level of acceleration, then it is our job to separate the wheat from the chaff. Our dedicated team is comprised of five members, two portfolio managers and three analysts, and during earnings season, we're all looking at the reports. We're focused on the names where acceleration can be sustainable, material, and underappreciated. A company may have been down 50% in earnings last quarter, 30% this quarter, and next quarter it might be down 10%. That's acceleration and we would consider that an attractive option. Then we ask ourselves which of the stocks that are accelerating also have improving relative strength.

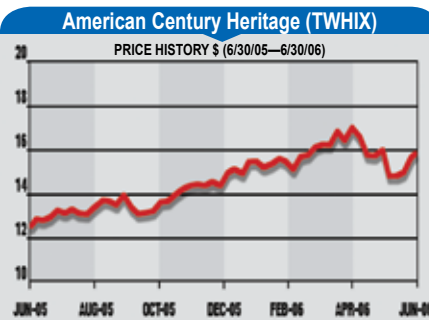
On a weekly basis, we monitor which areas of the market are accelerating and which ones are decelerating. And while a lot of our competitors look solely at an index benchmark, we have created our own strategy index that incorporates all the companies showing acceleration and positive relative strength. The portfolio tends to fall in between the benchmark index and our index. This monitoring

process allows us to avoid stocks in the portfolio from underperforming for long periods of time.

Q: If you follow the market, aren't you in danger of being called a 'momentum advisor'?

A: We focus more on earnings and revenue momentum than price momentum. Ultimately, it's the earnings and revenue growth that we're going to follow, but what about the "Wal-Marts" that you mentioned? There are companies with numbers improving for five years, yet the stocks still underperform. That's what we want to stay away from, with the assistance of our internal benchmarks and the weekly monitoring of industry and sector performance.

We recently looked at market sectors and recognized that the transportation area seemed to be working well, partially because last year was rough for transportation stocks while industrials were per-



forming really well. Since transportation has begun outperforming, we are spending more time researching this accelerating area. However, we have avoided the longer period of underperformance. If we'd only been looking at the earnings and revenue acceleration last year, we would have been hurt.

Q: Do you always start your research based on acceleration?

A: We may unearth a theme, and we'll research whether there are names that show the acceleration characteristics within the theme. Our research process may be initiated in a number of different ways; it isn't just waiting for the earn-

ings report. But acceleration is the basic building block.

Q: How does an idea become a holding of the fund?

A: I'll wrap it into an example, which refers back to the theme notion. For growth investors, the barge business has been an unattractive old area that few cared about. But recently, a company called American Commercial Lines came across on our acceleration screens and we began to look at it. The theme was right, the catalysts were right and the acceleration was going in the right direction.

Barge capacity is equivalent to 50 semi-tractor trailers and 15 rail cars but at a tenth of the cost. There's also a business called container on barges, which is a way of transporting the containers that you see running on the back of trucks. There's a lot of funding going into these containers on barge ports that we found appealing. Right now we have the lowest number of barges in the industry since 1982, so the backdrop looked phenomenal.

We found out that this company was the second-largest barge producer and that's 80% of their revenues. The growth numbers are astounding and can probably get better. That's where the acceleration part of the story comes in, including re-pricing of contracts and improved backlog. So this area, hardly owned by growth investors before, came to the forefront. The industry is improving, the companies have acceleration and revenue characteristics, and the pricing is just huge.

Q: What happens once it becomes part of your holdings?

A: We normally invest 50 basis points in the name initially to make sure it gets on board. Then we buy and sell stocks on a daily basis. Typically, we'd build a stock with a strong acceleration story rather quickly. We use a technical pricing indicator tool and combine it with fundamental indicators. We will make

the position larger as fundamentals or relative strength improves.

Q: What are the key elements of your portfolio construction process?

A: Generally, the portfolio is constructed of 90 to 100 names and we're always trying to concentrate it further. Right now, our top 30 names represent about 70% of the portfolio, up from about 62% back in February.

We go through the names on an individual basis and determine which ones are worthy of being in the top 10 and the top 20. They will be our best ideas and typically have more durable acceleration trends, themes, strong prospects for positive estimate revisions and potential for further multiple expansion. We've also got names on the "farm" team that may actually represent less than 50 basis points, but we hope they will become larger positions as our conviction level grows.

We also keep a close focus on which stocks have negative technical rankings to help determine whether or not they should remain in the portfolio. A deterioration in business trends or a persistent downtrend in relative strength will constitute a sale.

Q: Are you focused on a certain market cap range?

A: We're focused on mid-cap stocks. Right now we are about 60% mid-cap, 20% small-cap, and 20% large-cap, but we have our own way of looking at the world. We define our mid-cap sweet spot in between \$1 billion and \$10 billion in market cap.

We take into account how small caps are performing relative to large-caps. For example, large caps have recently been dramatically outperforming small caps and because of the relative strength portion, we may tilt a little more toward larger names.

Q: If you had similar acceleration codes and technical ranking for a

large and a small-cap stock, which one would you choose?

A: That's where the sector, industry and relative strength come into play. All things being equal between a trucking stock and a healthcare stock, for example, we'll buy the healthcare stock if the healthcare industry is working better.

Q: What is the turnover of the fund?

A: It's a little over 230% over the last twelve months. We're playing in a universe with high levels of growth and we're looking for sustainable accelera-

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tion, which doesn't maintain itself over a long period of time. I remember one particular situation where Analog Devices accelerated for nine consecutive quarters, but that's an exception rather than the rule.

Q: Since the acceleration and the pricing strength can expire rather quickly, for how long do you typically wait to make sure the trend is there? Can you afford to wait for several quarters?

A: I agree that there's a certain point where you're too far down the road. We have to move quickly when we get the first initial indication of acceleration. We typically don't really see anything happening after three quarters, as the acceleration phase generally does not last that long.

Q: You said that you don't follow any benchmark but which benchmark are you compared against? What is your view on diversification?

A: We have used the Russell Mid-cap Growth primarily because historically, it looks most like our portfolio. But we don't construct the portfolio according to that index.

More importantly, we use the internally constructed benchmark that I had mentioned earlier, which takes into account names that have acceleration and positive relative strength characteristics. If we can't find acceleration and the market has no interest in a certain sector, then we may not own many stocks in that area. We may stray from the public benchmark we're monitoring to invest in acceleration.

I believe that in a lot of ways, diversification can hurt you rather than help you. We're always trying to go with our best names and concentrate the portfolio because that's the opportunity for outperforming. While the market's going south and some may want to diversify and spread the risk out a little bit, we're taking the opposite approach and still trying to concentrate. **T**