

Concentrated and Confident in Value

The Security Large Cap Value Fund aims at long-term growth of capital, investing the majority of its assets in large-cap companies with total market value of \$10 billion and above. The management thinks about investment opportunities over a three- to five-year time horizon. They try to make fewer but better decisions based on the concept of owning businesses rather than stocks.

Q: What is the investment philosophy of the fund?

A: There are three things we consider very important. First, valuation is critical to our investment decision. We look for ideas with a margin of safety. Second, we think about investment opportunities over the long-term. We are very patient and try to find companies that can improve over a three- to five-year horizon. We are trying to own a business rather than a stock, so this leads to fairly low turnover.

Third, we develop a concentrated portfolio and are willing to take sizeable positions if the opportunities warrant. We are trying to make fewer but better decisions. For large-cap value, generally we own between 30 to 50 names.

Q: What is large cap from your perspective?

A: We define large cap companies as having market capitalizations greater than \$10 billion. The majority of our assets are in large capitalization stocks but

the weighted average market cap for the portfolio has typically been below that of our benchmark, the Russell 1000 Value Index.

Q: What is the value that you're seeking?

A: We look at value using enterprise value divided by invested capital (EV/IC) as the relevant metric. As of March 2006, the S&P 500 had a median EV/IC ratio of 2.1 times. We look for companies trading below that market median.

Q: How would you describe your investment strategy?

A: Fundamental analysis and valuation analysis drive our efforts. We consider ourselves bottom-up, fundamental analysis driven investors. Through our fundamental analysis we're trying to understand whether it's a good business or not. If it's not a good business today, we're trying to determine if there is potential for improvement. We believe that good businesses are able to sustain or

Security Large Cap Value A

FUND FACTS

Symbol	SECIX
Website	www.securitybenefit.com
Address	Security Management Company, LLC One Security Benefit Place Topeka, KS 66636
Tel. No.	1-800-888-2461
Inception	8/7/1944

PORTFOLIO

Total Net Assets *	\$92.7
Avg Mkt Cap (\$ Weighted) *	\$70,431
Average Price/Earnings Ratio	18.1
Average Price/Book Ratio	2.2
Turnover Ratio	33.92%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$100
Min Subsequent Investment	\$100
Min Initial IRA Investment	\$100

RISK (AGAINST S&P 500 - 3 YEARS)

Alpha	4.25
Beta	1.01
R-Squared	0.81
Ann Std Deviation	8.78
Sharpe Ratio	1.52

RETURNS VS. RUSSELL 1000 VALUE INDEX

	SECIX	Index
1 Year (Cum.)	22.39%	12.10%
3 Year (Ann.)	15.91%	15.70%
5 Year (Ann.)	4.63%	6.90%

RETURNS VS. S&P 500

	SECIX	Index
1 Year (Cum.)	22.39%	8.63%
3 Year (Ann.)	15.91%	11.22%
5 Year (Ann.)	4.63%	2.49%

FEES AND EXPENSES

Max Sales Charge - Front	5.75%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	1.61%

PORTFOLIO MANAGER

Mark A. Mitchell	6/30/05
James P. Schier	6/30/05

* millions

Data through: 6/30/2006

Source: Company Documents; Lipper



improve their pre-tax return on invested capital (ROIC) ratio over time. Our valuation analysis helps us understand whether this fundamental assessment is priced into the security today. We buy those companies where the market price does not reflect our expected value. We do this one company at a time.

In assessing the business, we try to understand if a company has a sustainable competitive advantage. I think about it as a triangle with sustainable competitive advantage in the middle. The three sides of the triangle are management, resources and opportunities. For management, we're trying to figure out if we understand the strategy of the management team. Do they have a history of creating shareholder value? Culturally, are they people you would want to work for? I firmly believe that the culture starts at the top and works its way down.

For resources, we consider whether they have the financial resources in place to sustain the business and the human resources to execute the strategy. Regarding the industry opportunities, we consider how competitive the industry is, how the industry is growing, and does the company have any unique product or services to offer.

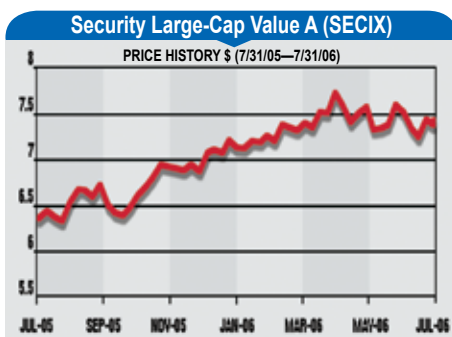
In our valuation analysis, we use the fairly typical valuation metrics, but we've also created our own tool set. If you imagine a graph, on the Y-axis you put EV/IC and on the X axis you put pre-tax ROIC. The X-axis shows how good the company is because the better the company or their competitive advantage, the higher returns they generate. We are able to plot all the companies in the universe or industry. Historically the market has shown a relationship between these two variables. We are able to fit a curve through the plots. We draw a line straight across the current market median of 2.1 times and the universe below that line is the one we're looking for – undervalued companies.

This tool allows us to compare how the market values a company today and

how they have valued it in the past by comparing it to the overall market and industry peers. New ideas typically trade at EV/IC levels where the market is not reflecting its current or future pre-tax ROIC.

Q: Do you tend to prefer companies that are below the market valuations?

A: Yes. However, not every cheap stock is an attractive idea. The error in value investing is that some companies will never earn higher ROIC figures. Some of the firms here will never be able to earn above their cost of capital. So we are looking for companies that are trading at attractive levels but have the opportunity to be a better company over the next 3-5 years.



Q: Modifying the book value of the mining, oil, or energy resource companies is a little tricky. How do you deal with that?

A: We can fit some of those companies into our valuation framework, but for some industries it does not work. For those where it does not, we use more traditional metrics. We try to focus on companies in our circle of competence and we try to expand it over time. When we make a mistake, we always try to evaluate what we could have done better. For example, it's amazing what some of the raw materials or the commodity companies have been able to do, and we've underperformed in that group because we don't know that group as well. But we've made it up in other places.

Q: Do you put similar emphasis on valuation metrics such as free cash flow or is that less important than the EV/IC?

A: Free cash flow is one company lever that can influence a company's ROIC. I can tell you what the free cash flow yield is on every name that we own or look at. At this point, we have not built the tool set around it, but we certainly think about it.

Q: How would you describe your research process?

A: We have four sector-based analysts. Our analysts focus on the consumer discretionary and staples, healthcare; financials and utilities and energy and materials. My experience was analyzing technology at GE Asset Management. I also help on the industrials.

Having sector specialists allows us to think outside the traditional Wall Street mindset. I'm thoroughly skeptical of Wall Street, partly because where they're very short-term transaction driven, we're long-term value driven.

Q: Generation of ideas can come from many places, including media reports, screening process or keeping up with trends. What's your way?

A: We use all three and a fourth one, networking with companies we know well. The networking part is about talking to various companies about them and about other companies. Not every management team is willing to do that, but the smaller the company, the more they might be willing to talk.

Q: Would the pharmaceutical industry have a better profile in your view?

A: We still think about it from a valuation standpoint. The large-cap pharma names still have high ROIC levels. Aside from Johnson & Johnson, which is a different story, we don't have any exposure to that group. Their EV/IC ratios have come down as their ROIC levels are decelerating. They've had all these branded

drugs with patent protection that earn incredible returns, but they've been their own worst enemy. They've grown too large to repeat this growth and that is combined with losing patent exclusivity.

Q: How do you approach the construction of this concentrated portfolio?

A: Our position sizes reflect our level of conviction. When you're running 30 to 50 names, the weight per name is somewhere between 2% and 5%. The maximum position size is nothing greater than 10%. Anytime a sector is greater than 10%, we generally try to limit ourselves to 2 times that weight, and any time a sector is less than 10%, we don't exceed 5 times that weight. From an industry standpoint we limit ourselves to no more than 25% in any industry. We make sure that we stay within the risk control parameters to manage a diversified portfolio.

Occasionally the markets give us opportunities. First Marblehead, the private student loan lender, is a perfect example. We were reviewing the company one day when news came about a transitory problem. It had already come down from \$75 to the high \$30s at that point. It was like a gift in terms of the hit that the stock took that day for something that didn't matter from a long-term standpoint.

First Marblehead's competitive advantage is the TERI database which includes 18 years of underwriting data. This database, in our opinion, provides them the ability to underwrite student loans better than anyone. This is an example where we started with a fairly small position, and as our confidence has increased our position has grown. We just don't believe the negative stories out there.

Q: Do you benchmark against any index?

A: We use the Russell 1000 Value Index.

Q: What is your objective in terms of turnover?

A: While we do not manage the fund with a specific target turnover in mind, we have over time ranged between 20% to 60%. There are some periods where

“We concentrate on securities where we believe the market price does not reflect a company’s ability to improve its pre-tax return on invested capital. Our analysts concentrate on understanding the competitive dynamics of companies. Through this analysis, we figure out how a company can improve over the long-term. Portfolio construction reflects our confidence.”



MARK MITCHELL joined Security Management Company, LLC in 2002. He manages the firm's Large Cap Value, Large Cap Growth and Large Cap Blend strategies. Previously, Mr. Mitchell was a portfolio manager and analyst with GE Asset Management from 1994-02. He earned a Bachelor of Science degree in finance from the University of Nebraska. Mr. Mitchell has earned the right to use the Chartered Financial Analyst designation.

we need to trade little, in other periods the market may reflect the opportunity we see more quickly.

Q: How would you describe your buy and sell discipline?

A: In terms of sell discipline, we have three reasons. First we sell 'if something dramatically changes'. Using First Marblehead as an example, such change could be if their advantage in underwriting student loans changes. That would be a pretty easy sell decision for us. Second, the more difficult one, is where the market fully reflects our valuation upside. And finally if we find a better opportunity in another name.

Q: What kind of risk do you perceive in terms of the portfolio, the sectors, or the security investments? How do you try to minimize that?

A: This is not something that we create hard fast rules around, but we think about it in this context: if we had owned ideas in just one sector, for example, we could have substantial risk if the world changed dramatically. Therefore, we focus on selecting securities from a bottom-up basis across all sectors. This tends to diversify the portfolio. And we tend to not limit where we can find value. You may have to look a little harder in certain places but this can diversify your overall portfolio risk. **T**

Ticker