

Chasing Growth in a Disciplined Way

The Chase Growth Fund is not a typical growth fund. With a fairly concentrated portfolio, it relies on a disciplined quantitative and qualitative process to build a high level of confidence in each idea. David Scott, manager of the fund, believes that the in-house research team and the extra step it takes in analysis are major assets. Building its own universe of growth companies, the fund often benefits from spotting stocks before they are included in the index.

Q: How would you describe your investment philosophy?

A: Our investment philosophy is based on the process of finding growth stocks at a reasonable price. The core belief is that over the long run, stock prices follow earnings growth so we seek consistent, long-term growth companies, or companies growing by at least 10% in four of the last five years. But we also seek companies that are reasonably priced and don't trade at earnings multiples relative to the growth rate that are in excess of the market rate.

The combination of growth and price is important because there are periods like the year 2000, when the companies with the fastest earnings growth reached prices that were unsustainable. If you continue to follow only consistent earnings growth without paying attention to the price discipline, you will end up with a very risky portfolio. So our philosophy is to buy the consistently growing companies that trade at reasonable prices.

It is also crucial to remain disciplined within our philosophy and process and to execute accordingly. We're full-cycle oriented and we're not trying to maximize performance over any short-term period of time. We're trying to build portfolios that perform well on a risk-adjusted basis.

Q: What is your investment strategy and process?

A: Our strategy combines quantitative and qualitative research to derive individual stock selections. We use a disciplined approach throughout the buying and selling process. We are looking for strong companies with strong stocks through a process that identifies long-term and consistent earnings growth patterns that are experiencing strong fundamental improvement currently. That's the basic profile of the buy candidates.

We start by screening a large universe of over 6,000 stocks, domestic and foreign companies trading in the U.S. The initial

Chase Growth Fund

FUND FACTS

Symbol	CHASX
Website	www.chaseinv.com
Address	Chase Investment Counsel 300 Preston Ave Suite 403 Charlottesville, VA 22902
Tel. No.	800-293-9104
Inception	12/2/1997

PORTFOLIO

Total Net Assets *	\$641
Avg Mkt Cap (\$ Weighted) *	\$59,600
Average Price/Earnings Ratio	17.9
Average Price/Book Ratio	4.5
Turnover Ratio	107%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$2,000
Min Subsequent Investment	\$250
Min Initial IRA Investment	\$2,000

RISK (AGAINST S&P 500 - 3 YEARS) **

Alpha	1.26
Beta	1.02
R-Squared	0.63
Ann Std Deviation	9.97
Sharpe Ratio	0.93

RETURNS VS. RUSSELL 1000 GROWTH INDEX

	CHASX	Index
1 Year (Cum.)	7.18%	6.12%
3 Year (Ann.)	12.53%	8.35%
5 Year (Ann.)	4.41%	-0.76%

RETURNS VS. S&P 500

	CHASX	Index
1 Year (Cum.)	7.18%	8.63%
3 Year (Ann.)	12.53%	11.22%
5 Year (Ann.)	4.41%	2.49%

FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee**	2.00%
Total Expense Ratio	1.15%

PORTFOLIO MANAGER

David B. Scott	12/2/1997
Derwood S. Chase, Jr.	12/2/1997

* millions ** risk statistics through 7/31/2006

Data through: 6/30/2006

Source: Company Documents



screen looks for earnings per share growth in four of the last five years of at least 10% and consistency of earnings growth. This screen yields about 600 names. The second set of screens focuses on the fundamental and technical profiles of the companies. The fundamental screen seeks to identify fundamentally strong companies that are performing well currently. It looks at factors like short and intermediate term earnings growth, return on equity, reinvestment rates, balance sheets, debt and equity ratios, and P/E ratios.

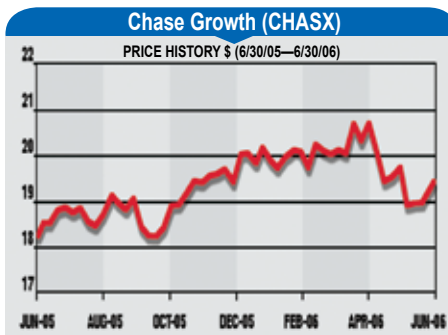
On the technical side, the primary screen is strong relative stock price performance versus the universe, but we also look at volume and price characteristics. We're looking at insider transactions and the volatility of the price action and we prefer the less volatile ones. We're looking for improving momentum of relative strength. We run the quantitative screens at least once a week and we usually identify about 40 to 60 companies that meet those criteria. The number of new names is actually smaller because we already own or have examined many of the names.

Unlike some fund managers, we don't stop here because while the quantitative process is a good way for generating buy candidates, it doesn't complete the job. We believe that individual stock selection is crucial when building the portfolio and added value is created by senior investment professionals.

Our analysts spend all of their research time following the companies that we own and looking at new ideas. At the initial phase, they verify the data to ensure that it's correct. Then they dig into the companies to determine the catalyst behind the performance. We try to find individual ideas with catalysts that may be new products, management changes, acquisitions, or something specific to the industry. It has to be something that indicates that the driving force behind the good current performance is sustainable. For instance, Johnson & Johnson just purchased Pfizer's consumer products division and that's a catalyst for us that should lead to more sustainable growth.

When a stock has been thoroughly analyzed by one of our senior analysts, he makes a recommendation whether to purchase a stock or not. He also recommends how much we should weight that stock relative to its benchmark weighting, if it is in the benchmark, and he'll present it to me as the senior portfolio manager.

Then I'll examine the idea and we'll determine a buy and a sell target for the stock. Generally, they won't bring me an idea unless it's relatively close to its buy target, but it could be slightly above the target. If it shoots up before we actually execute the trade, we may put it on a watch list and wait until it reaches the target price. We may decide to start with a smaller position and then build it into a bigger one as we grow more confident in the numbers, if things improve more rapidly than we expected, or if it pulls back to a price that makes it even more attractive.



Q: How is your research team organized?

A: We have a full research staff in house. All the portfolio managers were trained as analysts and we have two senior analysts with over 20 years of experience and a junior analyst to support them. The analysts have CFAs and/or MBAs and have worked in other shops. They do everything the Wall Street analysts would do in terms of examining the companies, talking to them, listening to the conference calls, or looking at the statements. We also have significant outside support from Wall Street and other independent research sources. It is a very research-intensive process.

Q: Can you give us some examples of how an idea generated through the process becomes a holding?

A: Bank of America is a fairly recent purchase and a heavily weighted stock in our portfolio. It's a well-known company that recently established an earnings record that qualified it as a buy candidate. Historically, it hasn't been seen as a growth company but it qualified as a consistent long-term growth company that met our fundamental and technical attributes.

The company had a number of different catalysts, including the overall environment favoring lower interest rates, which is beneficial to Bank of America because of its business mix. They made a number of acquisitions that have increased their ability to sustain above-average growth. Also, the company had a dividend yield well above the average. The analysis of the earnings estimates showed that they were likely to be raised in the future by other analysts on Wall Street. Finally, the stock was trading at a very reasonable price. Because of its size and attractiveness, we have built a position of 4% in our portfolio.

Another example is Intel, a stock that's included in the growth universe but we rejected it at the first level. In the late 90s Intel had a long-term record of consistent earnings growth but that changed after the technology recessions of 2001 and 2002. Although it is in the universe, we wouldn't buy this stock because of its record. That approach has helped us avoid many companies with deteriorating fundamentals that have ultimately fallen out of the universe.

Q: What's your portfolio construction approach?

A: We have about 35 to 45 stocks in our portfolio and position sizes can run up to 5%. There are several positions in excess of 4% and these stocks may be only 1% to 2% in the index. So we can significantly overweight positions relative to the index and that's why research is very important. It gives us confidence that we can take the idea and build it into a significant position. We believe that you have to take it one step

beyond the quantitative analysis to achieve this goal.

My role is to put the analysts' ideas in the portfolio in a way that ensures an above-weighted market position, but also a portfolio that's relatively balanced. While we're stock pickers, we diversify our portfolio for risk control purposes. We don't put more than 12% in a given industry and limit our positions to 5%. The largest of the large-cap growth companies are more heavily weighted than the smaller large-cap growth companies.

But we don't constrain the portfolio for sectors as we do for industries. The general guidance is just not to do something that would be imprudent. For example, when in 2000 the Russell 1000 growth was above 50% in technology stocks, we thought that such concentration would not be a prudent decision, so we held our weighting back.

Q: What is your view on risk control?

A: Overall, we'll look at individual stocks and the industry breakdown to make sure that we are not overly concentrated in a given industry. We make sure that we get enough diversification and we pay close attention to individual stocks to keep a reasonable balance without undoing the benefit from the individual stock selection.

But the primary risk control is at the individual stock level and that's in the sell discipline. Once the stock is purchased, it's monitored by the management team and by the analysts on an ongoing basis. The buy and sell targets can be adjusted for new information and we'll act in accordance with those targets.

If the stock reaches its target price and there's no justification for raising that target, the stock is a sell candidate. When we see the fundamentals and the outlook deteriorating on an ongoing basis, that's a reason to sell or reduce a stock. We follow various technical inputs such as relative strength, price volume characteristics, and insider transactions as key criteria for discerning violations for selling. And finally,

every week we evaluate if the new names on the list could be replacements for weaker stocks in the portfolio.

Q: What is the fund's turnover?

A: The turnover varies and we don't target a specific rate. It can be as low as 60% in some periods and as high as 125% in other periods. In periods with major rotation away from a group, like in 2000, the turnover is going to be higher. In years like 2005, when you're in the middle of a


cycle, the turnover will be lower, so it is determined by the individual stock, the sell discipline, and where we are in the market cycle.

Because of our risk-averse nature and our risk-control techniques, we tend to take small and short-term losses, while our gains tend to be longer-term and larger. We don't specifically manage for tax efficiency but the process tends to hold the winners and take small losses on stocks that don't perform well.

Q: What do you think is the major differentiator of your strategy?

A: I believe that the strength of our process is at each different level. We look at more stocks initially because of the quantitative screens, and then, we're consistent in the way we buy stocks. When we identify candidates, we don't stick only to the members of a particular index but we determine ourselves if it's a growth company or not.

For instance, we purchased several energy stocks before they became components of the Russell 1000 Growth index as they were clearly demonstrating consistent long-term growth. On the other hand, there are a lot of stocks in the index that no longer comply with the growth criteria and we avoid them. In many cases they fall out of the index later and the index funds end up selling them.

A major advantage is that we look for both fundamental and technical strength before we consider a stock. Often you'll only have one or the other and that can lead you into stocks that are poised to deteriorate. With the quantitative work, we try to build a very small universe of candidates that has a high probability of being successful. In the qualitative part we look at specific criteria that add value. The buy and sell targets keep us focused even if we adjust them. I also believe that it's good to have input from Wall Street brokers and other sources, but it has been particularly helpful through the years to have in-house analysts. 

“While the quantitative process is a good way to generate buy candidates, it doesn't complete the job. We believe that individual stock selection is crucial when building a portfolio and added value is created by senior investment professionals.”



DAVID SCOTT earned his BA in 1977 and a MBA with Honors in 1980 from the College of William and Mary. Before joining Chase Investment Counsel Corporation in 1994, he had 15 years of experience as an analyst and portfolio manager. He is a CFA charter holder and a member of The Richmond Society of Financial Analysts. He has been quoted in *Barron's*, *Business Week*, *Kiplinger's Personal Finance*, *The New York Times*, and *Value Line Mutual Fund Survey*. He has been a guest speaker on CNBC.

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