

Searching for Value in Stocks and Bonds

With a focus on capital preservation, Greenspring Fund aims at steady, non-volatile performance, regardless of what the markets are doing. This broad mandate, which enables the Fund to look for value in any capitalization range, is crucial for achieving its goal. Chip Carlson, the manager of the Fund, believes in knowing your boundaries and investing within areas you understand well.

Q: What's the investment philosophy of the Fund and how does it differentiate you from your peers?

A: I believe that our structure makes us unique in the mutual fund world. We're not part of a large family of funds, which in itself is very uncommon. To me that's a huge advantage, especially with our investment philosophy and objectives. Since 1983, when the Fund was launched, our goal has been to achieve steady performance with less volatility than the market averages.

We place tremendous emphasis on capital preservation, so we tend to do relatively well during difficult periods in the stock market. As an effect of our conservative approach, we may lag behind during a strong market, but in the long run, our overall performance matches that of the market, with a lot less volatility.

I view it as an old-fashioned approach where we try to buy undervalued securities that will do well for our shareholders in any kind of market environment, regardless of whether these are common stocks, preferred stocks, or convertible bonds.

Because we're not part of a family of funds, we have the flexibility to invest where we find the best values. Typically, we will be invested in common stocks and convertible bonds, especially in the last few years, although we're not pi-

geonholed into one particular style box. We invest a lot in small-cap value and mid-cap value securities but we do not have a mandate to be invested in them exclusively. That flexibility differentiates us from many mutual fund managers, who are forced by their mandate to be 100% invested in a particular style or capitalization range.

Q: Could you explain the benefits of this flexible mandate? Doesn't it also tremendously increase the number of securities you look at and, respectively, the pressure on the research side?

A: Yes, there is a wider universe available to us. There are more stocks and bonds that we can research to find a possible investment but I don't view it as a problem. I view it as an opportunity as we're not limited in what we can buy. From the research side it would be easier if we just invested in Russell 2000 value stocks and picked the best ones. Then my list would be much shorter, but I wouldn't be able to invest in a great idea outside of those boundaries.

Also, if your mandate is limited, in an environment, for example, where for some reason you don't consider small-cap value or mid-cap value stocks to be attractive, you'd still have to pick the best stocks in that area. The real advantage of this flexibility is it allows us to avoid areas where we don't see value and go to the areas where we do see value.

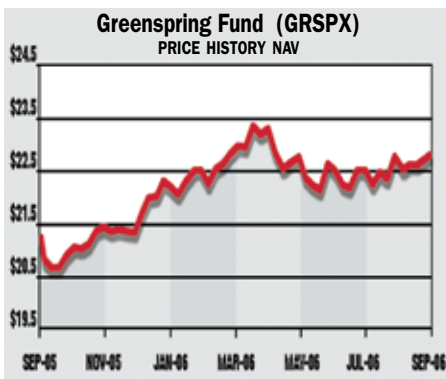


CHARLES vK. CARLSON (LEFT) is Portfolio Manager of the Greenspring Fund. Chip began his career as an analyst in 1983 and started co-managing the Fund in 1987. He is a 1982 graduate of The Johns Hopkins University with a B.A. in Political Economy, and he earned the right to use the CFA designation in 1986. Chip is married, has three children, and enjoys coaching lacrosse, playing Masters lacrosse, playing tennis and skiing.

MICHAEL J. FUSTING (RIGHT) is Senior Vice President and Chief Financial Officer of the Greenspring Fund. Mike graduated from Loyola College of Maryland in 1983 with a B.A. in Accounting and joined the Greenspring Fund as an analyst in 1989. He earned the right to use the CFA designation in 1994. Mike is married, has three children, and enjoys fly fishing, skiing, hiking and reading.

Both are members of the CFA Institute and the Baltimore Security Analysts Society. Chip and Mike are Co-Chief Investment Officers of the Fund's advisor, Corbyn Investment Management.

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That's why I feel that our approach is old-fashioned in a very positive sense. Our objective is to make money and, at the end of the day, I hate to lose money for shareholders, whereas many fund managers measure their success based upon their performance relative to some benchmark. In relative fund performance measures, if a fund is down 15% while its benchmark is down 20%, you've had a great year. We don't feel that way because we have a focus on absolute returns and a very different mindset.

Q: Do you also invest internationally or do you focus on the domestic market?

A: We're pretty much focused on the domestic market. We understand our limitations as we don't have the ability to analyze stocks in India, for example. However, if there's an international company that is headquartered in India but has its ADRs trading on the US market and reports according to GAAP standards, we would certainly consider that. We do have several securities that are technically foreign but I wouldn't say that we're international investors.

I believe that one of the keys to successful investing is sticking to what you understand so that you can have a well-informed opinion. You need to know where your borders are as the opposite can be very costly. One of the lessons we've learned over the years is to focus on the companies and industries that we understand.

Q: How do you translate this philosophy into an investment strategy and process? Do you have a preference for companies with certain characteristics?

A: Throughout the existence of the Greenspring Fund, we have had a balanced portfolio, which is split in some way between common stocks, preferred stocks and bonds, in pursuit of steady, consistent overall performance.

In terms of our equity exposure, we are definitely hardcore value investors. We invest where we find value, regardless of the capitalization range, but most of our securities are in the small and mid-cap area. Overall, we are looking in what we call 'the inefficient sector,' or stocks and bonds of companies that are not well followed by the investment community. That creates inefficiency in pricing that we can exploit. That's why we find more opportunities in the small-cap area, where the number of investment analysts is typically smaller and companies can fall through the cracks. But we also have several very large-cap holdings because they tie in well with our investment philosophy.

As part of our strategy, at least on the equity side, we're looking not only for value, but for value with a catalyst. That catalyst might be something as simple as change in the management, a new product, or even a macroeconomic event. We also look for companies that generate significant free cash flow and have demonstrated in the past that they can successfully reinvest it in the business or return it to shareholders in a favorable way.

On the bond side of the portfolio, we're again looking in the inefficient sector, where bonds can be under-priced relative to the level of risk. Over the last six to nine years, we have invested significantly in convertible bonds where the underlying common stock has dropped significantly prior to our purchase. The decline in the common stock causes the convertible bonds to also drop in price to a point where the convertible bond value is determined more by its fixed income characteristics, not by the ability of the holder to convert it into common stock. So the conversion feature is like an option on the future price of the stock. Because of the dynamics of the convertible bond market, we're able to pick up these busted convertibles at

very attractive yields, which is often superior to yields available on the straight bonds of similar companies.

Furthermore, there are several different paths to success with busted convertibles - we can sit tight and make the return; we can make money if the underlying common stock appreciates in price; or we can make money if companies are acquired and certain change-in-control provisions are triggered. Frequently corporations retire their debt in the open market and that helps to support the price of the bonds. That's a good example of an inefficient sector that has really helped us to achieve steady, consistent performance during a very volatile stock market.

In general, bonds tend to be less volatile than equities, and therefore, they help to reduce the volatility of the overall portfolio. In addition, when you purchase a bond, you're buying it at a given yield to maturity. Assuming that you've done your homework and that the company makes timely interest payments and retires the bond at maturity, you will earn the yield that you expected at the time of purchase. Your exit strategy is defined. Unlike an undervalued stock that may stay undervalued for an unexpectedly long time, the return when buying an undervalued bond is more certain.

Q: Could you highlight some of the important issues of your research process?

A: Although there are differences when researching stocks and bonds, there are many similarities in our approaches. We want to understand the companies, their business, and how they make money.

As far as bonds are concerned, we spend a lot of time in understanding the business, the expected profitability, and the cash flow generation ability of the company. Most of the bonds we like typically have short maturities and, consequently, our analysis does not have to be a long-term analysis. We look for what the company is doing currently, the projections, and what we expect in the foreseeable future. Then we spend a lot of time looking at the balance sheet, the

current capital structure, the amount of cash on hand versus near-term debt maturities. We examine the company's ability to access the capital markets if we think that they'll need such access to retire debt. We don't like to gamble on the fixed income portfolio.

Regarding the research of equities, again we try to understand the company, the industry, how the company makes money, what trends the income and cash flow statements show. We focus on the company's ability to generate free cash flow and to use that cash flow wisely. We also check to see if the management's interests are aligned with the shareholders, if its strategies will help to increase the stock price, and we're looking at management motivation.

In general, there is no formula. We don't have a computer program that spits out 12 different names a week. Basically, we do it the old-fashioned way, reading the 10 Ks, the 10 Qs, Annual Reports. When Wall Street research is available, we'll look at it, although we'd rather understand the company ourselves. We also read industry materials, articles in the press, and we'll talk to the management if we think that's necessary. We visit companies if that's helpful, although sometimes that can hurt you if you get too wound up in the romance.

Overall, we follow a process of understanding how the company makes money, familiarizing ourselves with several years of financials, understanding what they've done in the past, how the management has run the company and re-invested earnings over time. So it's a process that is not by a formula, but one that requires a lot of involvement from us.

Q: Moving on to portfolio construction, how many stocks and bonds do you have? What is the split between stocks and bonds and is that an important issue for you?

A: Currently we have about 45 stocks and 20 bonds, which is a fairly typical distribution. We believe in making investments that are significant enough to affect the portfolio's performance.


Our risk management is accomplished by good market research and analysis; we're not proponents of overly diversifying the portfolio.

We don't believe that there is any benefit in owning 200 equities as opposed to owning 30 equities. With our approach and the research-driven methodology that we use, we would rather own 40 or 50 equities in the portfolio that we understand well. We wouldn't buy the top 12 names in the telecom sector, for example, just because we've decided that we like that sector. We have a bottom-up approach and we keep the names down to a reasonable limit so that we can understand them well, while at the same time, we're not over-concentrated in any particular company or industry.

Q: What kind of risks do you perceive and how do you monitor and mitigate them?

A: We have tremendous focus on capital preservation and that has been a real driver for our fund. We have been able to perform well during difficult stock market environments through credit analysis, spending a lot of time on balance sheet analysis, cash flow generation, and the company's ability to access the capital market. Also, we keep the duration of the bond portfolio very short so the holdings are not swung around by changes in interest rates. That's how we limit the risk of the bond portfolio, which has been a stabilizing factor of the overall portfolio.

In terms of equities, we're very patient when we buy stocks. We don't invest until we have a good entry point and we'll wait for the risk/reward that makes sense to buy for our Fund.

On the sell side, we're more than willing to sell securities when they trade at what we consider fair value. When the situation does not develop in the way we anticipated, we don't hesitate to sell. If the initial reason for the purchase is no longer valid, we spend time re-evaluating things and it's been very valuable to cut losses quickly. That's the mentality and the framework that helps us do pretty well during a difficult stock market environment. 

Greenspring Fund

Symbol	GRSPX
Website	www.greenspringfund.com
Address	Greenspring Fund 2330 West Joppa Road, Suite 110 Lutherville, MD 21093
Tel. No.	800-366-3863
Inception	7/1/1983

PORTFOLIO

Total Net Assets *	\$225
Avg Mkt Cap (\$ Weighted) *	\$5,506
Average Price/Earnings Ratio**	16.3
Average Price/Book Ratio**	1.8
Turnover Ratio***	36.22%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$2,000
Min Subsequent Investment	\$100
Min Initial IRA Investment	\$1,000

RISK (AGAINST S&P 500 - 3 YEARS)

Alpha	0.30
Beta	0.65
R-Squared	0.56
Ann Std Deviation	2.20
Sharpe Ratio	1.29

RETURNS VS. LIPPER FLEXIBLE FUND INDEX

	GRSPX	Index
1 Year (Cum.)	7.48%	8.47%
3 Year (Ann.)	11.80%	10.62%
5 Year (Ann.)	10.80%	6.98%

RETURNS VS. S&P 500

	GRSPX	Index
1 Year (Cum.)	7.48%	10.79%
3 Year (Ann.)	11.80%	12.30%
5 Year (Ann.)	10.80%	6.97%

FEES AND EXPENSES

Max Sales Charge - Front	N/A
Max Sales Charge - Deferred	N/A
Max Redemption Fee	2.00%
Total Expense Ratio***	1.16%

PORTFOLIO MANAGER

Charles vK. Carlson	1987
*millions **as of 10/10/06 ***as of 12/31/05	
Data through: 9/30/2006	
Source: Company Documents; Lipper	

Ticker staff searches for mutual funds for their consistency in performance and durability of investment style.

Our interview covers investment philosophy and strategy, research process, portfolio construction and risk control for funds. Through an interview we uncover long-term strategies and processes that help to generate long-term returns.

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