

## Consistent and Less Volatile

*Quite different from its peers, the Ave Maria Growth fund invests in a relatively small number of domestic stocks that it selects through a systematic ranking system. The manager, James Bashaw, is free to invest in companies of any size as long they fit with the requirements of long-term risk-adjusted expected returns. But regardless of their attractiveness, the fund does not invest in companies that offend Catholic values.*

**Q: What's the investment philosophy of Ave Maria Growth Fund?**

**A:** We believe that the way to outperform in the growth equity world is to operate with a very structured, disciplined approach. We have a long-term view and our goal is to exceed the returns of the S&P 500 index over a full economic cycle.

The fund is 100% invested in common stocks of U.S. incorporated companies. We carefully select the securities through a bottom-up process and we diversify among eleven economic sectors as defined within the S&P 500. Overall, we're trying to find the companies with the highest return on equity, highest earnings retention, and lowest relative price. We rely on an information system that ranks our universe according to the companies' attractiveness over a three-year time horizon.

In our philosophy, market capitalization is irrelevant. We have mid-cap stocks in the portfolio, such as Graco with \$2.6 billion market cap, and large-cap stocks such as Stryker or Harley Davidson with market cap of more than \$15 billion. We go where we find attractive returns regardless of market caps. Over time there are attractive and unattractive big and small companies.

Another important aspect of our philosophy is that we avoid companies that are offenders to Catholic values and principles, even if those securities are attractive. For example, we think that Pepsico is attractive but it's not in the fund. In other words, we

avoid companies that have anything to do with contraception, abortion, pornography, offering corporate benefits to unmarried couples and others.

**Q: How do you select the companies you invest in?**

**A:** Our information system ranks a universe of 200 common stocks in order of risk-adjusted expected return. Based on the current price, an estimate of the interim dividends, and a terminal liquidation price, we are able to compute the discounted cash flow rate of return. The next step is adjusting that return for the risk.

We differ from other fund managers because we don't pay too much attention to beta. The risk-adjustment process takes the historical standard deviation of the actual returns of the stock and compares that to the historical standard deviation of the average stock in the S&P 500. Then we adjust the computed rate of return for the relative risk.

After the 200 companies are evaluated, we divide them into four sets of fifty companies. The top fifty companies are the top quartile of our ranking; the second and the third sets represent the hold zone; and the fourth set of 50 companies consists of securities that are much lesser attractive and are candidates for selling. We monitor and measure our performance every day and, at present, 80% of our equity assets are in the first two quartiles and only 1.2% of the assets are in the fourth quartile.

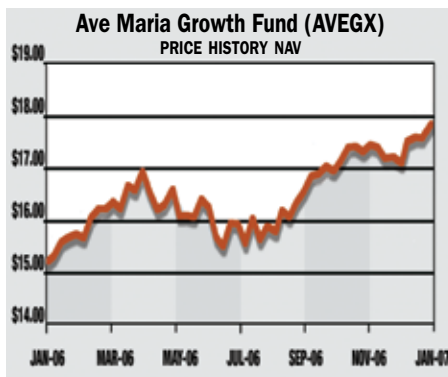


**JAMES L. BASHAW** CFA - President

Prior to founding JLB & Associates, Inc., in 1983, Jim was Director of Research for a \$7 billion trust division of a major Detroit bank.

Mr. Bashaw has a Bachelor of Industrial Engineering from the University of Florida and a Master of Business Administration from the University of Michigan. Additionally, he served as President of the Investment Analysts Society of Detroit.

**“We’re trying to find the companies with the highest return on equity, highest earnings retention, and lowest relative price.”**



**Q: What guidelines do you follow in your research process? Could you give us an example of an idea that became a holding?**

**A:** One of the things we do is screen for companies with good earnings track record, but it's not all numbers. For example, we have Graco in the portfolio, a company that does something very ordinary. It makes pumps that move fluids for grease guns and paint sprayers or pumps that move liquids that need to be sterile that are used in the bottling of wine or milk, for example.

Years ago the company attracted our attention as a company that was not in a super hi-tech industry or in retail. It is in a seemingly ordinary business, which they do very well. Graco has return on equity of 46.3% and it sells at a multiple of 15.9 times earnings. It generates 41% of its sales overseas but it is incorporated in the U.S. and we don't have to worry about foreign accounting, the instability of foreign governments, or the currency exchange.

**Q: When you generate an idea, do you take the decision solely based on the publicly-available information and the numbers? Do you visit the companies?**

**A:** Years ago I used to visit companies and I never learned anything negative. It's all positive and the only way to learn something useful is to go to the manufacturing site, for example, to see what the house-keeping is like, talk to the people on the line, or to the competitors and suppliers.

In the case of Toro, for example, I went to a large dealer who's been in the business for years. We discussed his opinion on the management and he described several positive things, positive, so that reinforced

the decision to purchase Toro. But we don't do that with every investment decision.

We like to make our own decisions and we don't purchase decision-making from sell side analysts because we're tied to our own beliefs, process, structure, and discipline. Our rankings have a rational basis to distinguish between the most attractive and the least attractive stocks.

**Q: Do you adjust the earnings that you use for ranking the universe?**

**A:** Yes, we adjust earnings. For example, if you look at the research services that provide information on Kellogg, you'll find that return equity is very, very high. But that's not only because the company's business is doing well so we feel a need to adjust it. When a company buys in its own shares, its cash goes down and there's a negative adjustment in the net worth section of the balance sheet. So when a company buys its stock over long periods of time, the net worth section can be notably reduced and that's the denominator for computing return on equity. The result is that the return on equity increases without the returns actually increasing.

We'd rather have adjustments on the asset side to account for the buybacks. To offset the decreasing cash we would prefer an entry called, "Investment in Company Stock". So we divide the absolute level of net income by the net worth, which is adjusted by putting back the dollars used to purchase the stock. Some people may say that we've unduly depressed the rate of return, but after our adjustments Kellogg still cleared the bar as an effective security and turned out to be a buy decision.

**Q: So you don't consider stock repurchases to be a positive factor. Is that correct?**

**A:** If the only thing you can do with your cash is to buy all of your own stock, you would be liquidating the company. You ought to be able to find something business-like to do with that cash. But we have to be pragmatic and recognize that all investors don't look at it that way. Some consider it to be one factor that might make a stock attractive. Also, if the repurchased stock goes

up and if the company decides to have a secondary issue, they can make a profit on their own stock.

The other effect of the repurchases is to reduce the dividends the company has to pay. When they use the cash, theoretically they get back appreciation in their own stock plus savings from the dividend. So the idea is that the total return is going to exceed the opportunity cost of keeping the cash.

When companies have huge amounts of cash, as in the case with Microsoft, there can be a lot of pressure to increase the dividend. In 2005, when Microsoft paid a special \$3.00 dividend, you could see the spike in personal income in economic charts. So a stock repurchase would decrease the cash and alleviate the pressure on management to pay large dividends.

**Q: Would you explain the idea of being indifferent to market capitalization? Why do you believe that this is a better way to manage money?**

**A:** If you look at the total market cap of the S&P 1500, which is made up the three indexes that cover the capitalization ranges - the S&P 500, the S&P 400, and the S&P 600 - you'll see that the S&P 500 makes up 88% of the total market cap, the mid-cap index makes up 8%, and the small-cap makes up only 4%. To me it doesn't make sense to go benchmarking in the small-cap arena as the benchmark represents only 4% of the entire market.

I'm sure that somewhere along the line Microsoft, despite being a size leader in recent years, presents growth opportunities. If you exclude it because you think it is very large, and therefore mature, you bail out of a company that continues to do a great job. So I'd rather invest regardless of the company size, just concentrating on finding approximately 30 good companies for a portfolio.

**Q: What are your portfolio construction principles?**

**A:** Currently there are 37 stocks in the Ave Maria Growth Fund; and, they are approximately equally weighted. Different from

other managers, we don't feel that we're so clairvoyant to place different weights on the stocks that we believe are attractive.

We keep track of the portfolio in terms of the diversification among the 11 economic S&P sectors but we're not trying to mirror the index. For example, although many healthcare companies are excluded from the fund as offenders, we still have 16.1% of the fund in healthcare, which compares to 12.9% in the S&P 500. The Utilities, which represent about 3.5% of the S&P, are not included in the fund because they tend to have low return on equity and high dividend payouts, which doesn't fit with our investment approach.

The general idea is to construct a portfolio that is more profitable which might also trade at slight premium to the S&P 500 price/earnings multiple, other things being equal. The weighted return on equity for the portfolio is 24.5% compared to 17.9% for the S&P 500, in the way we measure it. The earnings multiple for the fund on average is 16.8 times the 2007 earnings against 15.7 for the S&P 500.

**Q: With 37 holdings and a long-term approach, one would expect that you also have a low turnover. How do you deal with the short-term market volatility?**

**A:** Turnover tends to be low, currently at about 30%, but it could be lower on an ongoing basis. We differ from other funds because we make longer-term capital investments. We have the securities ranked and most of the money is in the top range of the ranking. The securities just don't race to the bottom and cause us to sell and create a high-level turnover.

The strategy of higher return on equity and lower price-to-earning ratios is going along with the market, which goes up about 77% of the time, according to long-term studies. In the period 1941 through 2005 there's only been fifteen years when the market was down. There'll be overweight companies in the portfolio or companies that go up a lot relative to


the rest, so we'll cut them back. But that doesn't happen overnight and we're not the kind of managers that buy something and sell it if goes up five to ten percentage points.

**Q: How would you describe your sell discipline?**

**A:** We sell securities if they appreciate so much that they move from appearing attractive in the top quartile to being unattractive in the fourth quartile. Another aspect is when a security that performs well, becomes substantially overweighted in a portfolio. We cut it back because we want to avoid the possible negative impact of a security that's done great and then reports a disappointing quarter, drops in price, and has a disproportionately large impact. A third reason for selling would be if a company has a continuum of problems, regardless what the numbers say. An example would be Merck with the Vioxx problem but that doesn't apply to the fund because Merck is an offender.

**Q: What is your view on risk at the fund and the security level?**

**A:** I look at risk as the historical standard deviation of the average return for the stocks in the portfolio, measured against the standard deviation of the average stock in the S&P 500. To me the definition of risk is the volatility of the return line. It's clear that the S&P 500 is more risky than the 30-year Treasuries and you can see that by observation because of the volatility of the return line.

For our portfolio, the standard deviation of the average stock is 24.8%, which means that the average stock could go up or down by 24.8% in any year and two-thirds of the time be statistically insignificant. The standard deviation of the average stock in the S&P 500 is 34.9%, which means that the fund has notably lower standard deviation with better return on equity and with a price-to-earnings multiple that is slightly more expensive than the S&P 500. It may not be a perfect process but it has been a good journey and so far has been rewarding. 

## Ave Maria Growth Fund

Symbol	<b>AVEGX</b>
Website	<a href="http://www.avemariafund.com">www.avemariafund.com</a>
Address	Schwartz Investment Counsel Inc 3707 West Maple Rd, Suite 100 Bloomfield Hills, MI 48301
Tel. No.	888-726-9331
Inception	5/1/2003

### PORTFOLIO

Total Net Assets*	\$85.4
Avg Mkt Cap (\$ Weighted)*	\$6,615
Average Price/Earnings Ratio	18.5
Average Price/Book Ratio	4.4
Turnover Ratio	N/A

### INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$1,000
Min Subsequent Investment	\$0.00
Min Initial IRA Investment	\$1,000

### RISK (AGAINST S&P 500 - 3-YR)

Alpha	2.07
Beta	1.11
R-Squared	0.65
Ann. Std Deviation	9.39
Sharpe Ratio	1.02

### RETURNS VS. S&P 500 INDEX

	AVEGX	Index
1 Year (Cum.)	18.47%	3.54%
3 Year (Ann.)	13.72%	10.44%
5 Year (Ann.)	N/A	N/A

### RETURNS VS. MORNINGSTAR MID GROWTH TR INDEX

	EVTMX	Index
1 Year (Cum.)	18.47%	11.12%
3 Year (Ann.)	13.72%	-0.54%
5 Year (Ann.)	N/A	N/A

### FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	1.00%
Max Redemption Fee	0.00%
Total Expense Ratio	1.50%

### PORTFOLIO MANAGER

James L. Bashaw	05/01/2003
-----------------	------------

\*millions

Data through: 01/31/07

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.

You can read more on this and other funds at [Ticker.com](http://Ticker.com)