Getting the Big Picture Right

The ThomasLloyd OPTI-flex Fund is a fund of funds that utilizes an opportunistic approach by investing in mutual funds in various asset classes, investment styles, market capitalizations, and in funds that leverage or short the markets. As a result, Portfolio Manager Jeff Unterreiner believes that the fund is adequately diversified to be a life-time investment that should outperform through a full market cycle.

Q: How would you describe the core beliefs behind your way of managing money?

A: This is a fund of mutual funds, a strategy that stems from our privately managed client accounts program but offers the simplicity of a single mutual fund. First of all, we believe in the longer-term stock market and stock ownership. There are certainly times when investors overbid stock prices and we can use these opportunities to reduce our stock exposure and put money to better use in bonds or other investment strategies.

A core belief behind our investment strategy is that many investors do not make short-term investment decisions on an entirely rational basis. However, although investors may be irrational in the short run, they are not likely to stay that way. If we can identify in what way large groups of investors are being irrational, we can anticipate the inevitable correction and move ahead of the market.

Our philosophy is based on the understanding that each component of the market moves significantly as money comes in or goes out. If we can determine what industries, sectors or asset classes are likely to have changes in investment behavior, we can profit from the cash flows that follow.

For example, investors were "irrationally exuberant" toward technology stocks - and possibly the market in general - in 1999 and 2000. Our model shows that bonds were much more favorably priced during this period, and over the following three years investor behavior changed in preference of bond market returns, confirming the forecast. By the beginning of 2003, investors were avoiding the stock market despite the value available there and continuing to favor bonds despite much lower yields. At that point, we anticipated investor behavior changing in favor of stocks.

Q: Would you call it contrarian investing?

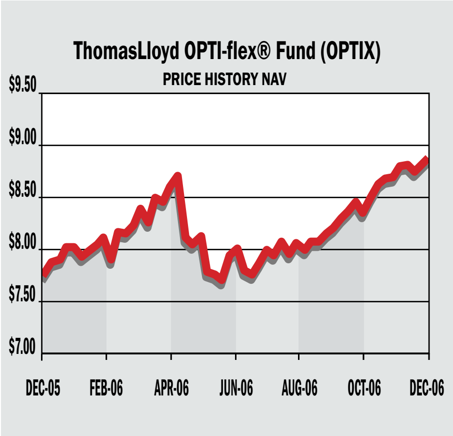
A: It is investing that involves contrarian views. Quite simply, the consensus is probably wrong, but sometimes it's hard to tell if the market has reached that point of consensus. We need to establish the basis of "reasonable" before we can determine whether investors are being "irrational". This can take the form of looking at earnings expectations, which became excessive in the late 1990's, and looking at buying bond yield as an investment alternative to buying earnings in the stock market.

Q: How do you turn that philosophy into an investment strategy and process?

A: Overall, our approach is based on top-down research that looks at economic data, technical trends, relative valuations, and investor behavior. Our aggre-

JEFF UNTERREINER is portfolio manager of the ThomasLloyd OPTI-flex® Fund and President of PROACTIVE Money Management, Inc., sub-adviser to the Fund. A veteran of more than twenty years in the financial services industry, he played a key role in the development of the OPTI-flex® Money Management Strategies, serving for eight years as chief technical analyst. Mr. Unterreiner succeeded his father as portfolio manager of the Fund in August 2002 and currently manages more than $35 million in the OPTI-flex® strategies through separately managed accounts. Mr. Unterreiner is a graduate of the School of Business Administration of the University of Missouri at St. Louis, where he received his bachelor's degree in finance. Mr. Unterreiner is a member of NAAIM and served on the founding board of directors of the Fund of Funds Association.

"We start by aiming to get the big picture right. The decisions between growth and value, small-cap vs. large-cap, and industry allocations can be significant, but by far the largest determinant of performance is our macro stock/bond allocation."



gate findings determine the fund's asset and sector allocation. Finally, for each sector, asset class, capitalization range and investment style, we choose the best managers based on performance history, portfolio manager tenure, investment strategy, and expenses.

More specifically, our process can be described as a two-bucket approach toward investment allocation. The first bucket, which shapes about half of the portfolio, is big picture asset allocation. Since asset class allocation dictates the majority of a portfolio's return, we believe that getting this big picture right is our primary responsibility.

The second bucket involves a diversified combination of five different investment strategies with various degrees of correlation to the market and to each other. Since these five strategies perform differently in each market environment, our diversified approach allows the fund to perform well through the full market cycle.

Q: What type of strategies do you usually have in that part of the portfolio?
A: We usually have 10% in a short-term trading approach. If we expect a short-term decline - even if the market is attractive - we may decide to short the NASDAQ or other index through a fund family like Rydex.

Another 10% of the portfolio is invested in long-short or other hedge-type strategies. Within the long-short strategy, we utilize proven managers who aren't so much making a call on the direction of the market but rather making decisions on which industry groups or stocks within an industry group will outperform. We also use funds that invest in distressed securities, arbitrage opportunities, or other hedging strategies, the majority of which do not correlate highly to the overall market and thus help to reduce the portfolio's beta.

We usually hold 10% in bonds for diversification, even if our model deems bonds unattractive by comparison. The bond portion lowers the portfolio's risks and provides consistency. Depending on our macro view, we decide between short-term or long-term bonds, high-yield, government, or international bonds, but we always have a minimum bond allocation.

Another 10% of our portfolio invests in core value funds, because value stocks tend to outperform growth and exhibit less volatility over time. Even when the market is not attractive, we still want to have some core value exposure.

Finally, we have 10% in focused funds that benefit from the fund managers' best investment ideas. Within this strategy we look for experienced managers with concentrated portfolios of just ten to twenty stocks to take advantage of the manager's investment expertise.

Q: What are the most important elements of your research process?
A: We use a top-down approach with the goal of finding value in the market. By "value" I don't necessarily mean value stocks, but any type of investment with the potential to outperform. For example, we saw value in high-yield bonds in 1990 and we can see value in growth stocks as long as the premium paid is not too high. In the mid 1990s, growth and value stocks were trading at equal price-to-earnings ratios and, from that level, growth stocks did outperform through the end of the decade.

We also do a lot of research on S&P 500 earnings versus bond yields because, when you're buying stocks, you get your share of the future earnings. This may be a fairly simple analysis, but few investors do it.

Q: What benchmarks do you use for reporting or construction purposes?
A: As equity investors, we look at our performance relative to the S&P 500. In addition to the S&P 500, I also use a more detailed benchmark, which is an average of the "market return" and a fixed return of 10%. We calculate the "market return" as an average of the Wilshire 5000 Index and the Dow Jones World Stock Index. I think that this modified benchmark represents what most of our clients are looking for in balancing risk and return.

Accounting for a 10% fixed return in our benchmark means that if the market has a good year, we're not necessarily trying to keep up. We want to provide a good return, but we're not trying to beat the market when it's exploding upwards because this fails to balance risk and return adequately. Likewise, on the downside we're trying to provide a lot of protection in extended declines.

As you can see, we're not trying to promise a positive return regardless of what the market does. When the market goes down 24%, as it did in 2002, the benchmark calls for investors to expect and accept a 7% decline. Basically, we're trying to deliver a good return and to outperform throughout the market cycle.

Q: Can you give us a couple of examples of specific stocks or investment decisions that illustrate your research and thought process?
A: We leave the individual stock selection to the mutual fund managers in our portfolio. An example of a mutual fund that we've bought recently is CGM Focus Fund, a focused fund whose manager has the ability to short certain sectors.

In 2002 he was shorting technology, and for most of the bull market since 2003 he's been overweighting energy and real estate. We don't put any significant restrictions on the manager and he has the flexibility to position money as he wants. Since he has a good record, we are more comfortable with his decisions.

Another example is that we've found that small caps tend to outperform the market when we are coming out of recession, so in 2003 we made the decision to overweight small-cap funds when we increased our stock positions. The FBR Small-Cap Fund came up in my research as a fund with a low P/E ratio, which benefits from a concentrated approach and has performed well since inception.

However, my strategy is probably best illustrated by looking at the first bucket of our approach, namely, getting the big picture right. In 2000 I was concerned about the stock market because price-to-earnings ratios were about 40 with stock earning yields of about 2.5%. At the same time, corporate bonds were available with yields in the 8% or 9% range. My thinking was that many equity investors would be interested in bonds just because bonds offered more return for the dollar, despite the fact that bonds don't have the growth potential of stocks.

This stock-vs.-bond analysis showed a very different picture in 2003. Stock earning yields were in the 5% to 6% range on a forward-looking basis, while bond yields were down to the same 5% to 6% range. Since earnings tend to grow over time, you usually need to pay a little more than you're paying for the bond yield, and that made stocks look attractive since 2003.

Q: What is your view on risk control?
A: Our overriding view on risk control is that there are times to be concerned about risk and times not to be concerned. Investors had to be really concerned about risk control and to limit stock exposure prior to the beginning of 2003. Since then, it's been time to participate in the market's growth. There is volatility, but it's not the time to be overly concerned about the risk or to take stop-loss measures when the portfolio goes down in the short-term.

The biggest risk control that we have is tracking what you're getting for your dollar. When you're buying stocks at a price-to-earnings ratio of 40 as in the year 2000, there's significant reason to focus on risk control. While there are no established risk controls per se, we control risk by limiting stock exposure in periods like 2000 or 1987 when there are much better alternatives readily available.

Another important part of our strategy is that we consider investment expectations. What really moves the market is the relation between earnings and expectations, so changes in expectations are quite important to our analysis. When expectations are low, as in 2003, reality is more likely to be in line or better than expectations. When expectations are high, it's time for caution.

As a factor of the research that I've done on investment expectations, I have a propensity towards value investing. Over history, growth companies tend to expect 18% earnings growth rate but deliver 8%. Value companies tend to expect 8% earnings growth rate and achieve a 6% growth rate. All other things being equal, I'd prefer the companies that get 75% of their expectation versus the companies that only get 40%.

The net effect of our "big picture allocation" and diversified strategies is that when stocks are attractive, we will usually have between 50% and 100% exposure to stocks. When stocks are unattractive, we will usually have between 0% and 50% stock exposure. This framework is what we mean when we talk about getting the big picture right.

ThomasLloyd OPTI-flex® Fund

FUND FACTS

Symbol	OPTIX
Website	www.thomaslloydfunds.com
Address	ThomasLloyd Funds 427 Bedford Road Pleasantville, NY 10570
Tel. No.	888-337-5132
Inception	10/1/1996

PORTFOLIO

Total Net Assets *	$ 6.4

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	$ 1,000
Min Subsequent Investment	$ 100
Min Initial IRA Investment	$ 500

RISK (AGAINST WILSHIRE 5000 - 3 YEARS)

Alpha	0.20 %
Beta	1.18
R-Squared	0.78
Ann Std Deviation	10.52 %
Sharpe Ratio	0.28

RETURNS VS. WILSHIRE 5000

	OPTIX	Index
1 Year (Cum.)	17.51 %	13.89 %
3 Year (Ann.)	14.64 %	9.69 %
5 Year (Ann.)	11.43 %	5.89 %

FEES AND EXPENSES

Max Sales Charge - Front	0.00 %
Max Sales Charge - Deferred	1.00 %
Max Redemption Fee	0.00 %
Total Expense Ratio	2.40 %

PORTFOLIO MANAGER

Jeffrey J. Unterreiner	8/1/2002

* millions

Data through: 12/31/2006

Source: Company Documents

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