

Before the Street Does

The negative consensus among investors and analysts on troubled companies only provokes the interest of Sergio Marcheli, one of the portfolio managers of the Van Kampen American Value Fund. But the final ‘buy’ decisions are taken based on in-depth fundamental analysis, assessment of the management and its chances to turn the company around, and the mandatory presence of a positive catalyst. That strategy aims to discover the success stories before everyone else on the Street.

Q: What are the core beliefs behind your way of money management?

A: We invest in undervalued companies that, we believe, are experiencing a positive catalyst. We believe that the companies are typically undervalued for a reason, and we expect them to remain undervalued, unless a catalyst occurs. We also believe that entire market is cyclical, so we need to be cognizant of that when we make our investment decisions.

We focus on the stocks for which the consensus view is negative because, in those cases, we believe most of the negative news is already priced into the stock and, therefore, there’s not a lot of downside risk left. If the majority of analysts have a negative view or “sell” recommendation on a particular stock that we believe has attractive value characteristics, we definitely want to take a look at that company.

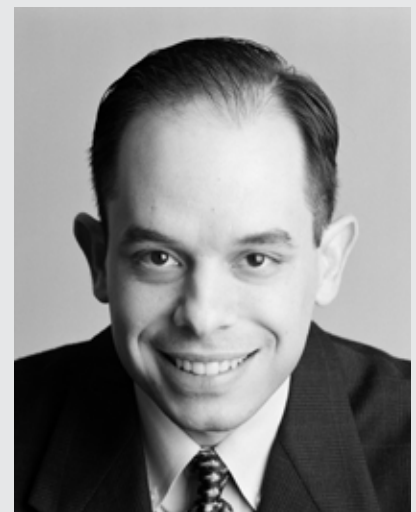
Similarly, we would generally begin to sell a security when the analysts’ consensus becomes more favorable and the analysts begin to upgrade the stock. If there are positive developments in a company, sooner or later we expect the analysts will make upward revisions, and we want to be ahead of that.

Q: How do you translate your philosophy into an investment strategy and process?

A: To find these undervalued companies with a catalyst, we rely primarily on fundamental analysis. Three members of our team have accounting and auditing backgrounds and two hold CPA licenses. That’s very important for us, because from the standpoint of fundamental analysis, we should be able to get an understanding of what’s going on within a company through its income statement, balance sheet, and cash-flow statement. That approach helps us to understand what’s going on, why the company is undervalued, and how plausible it is to turn the company around.

From a valuation standpoint, one of the critical screens is enterprise value to sales. Enterprise value is the market capitalization of a company adjusted for its debt and cash, so we believe it is a better measure of a company’s worth than the market capitalization. We prefer to use sales because sales typically represent what we consider to be the “cleanest” part of the income statement, while earnings can fluctuate over time.

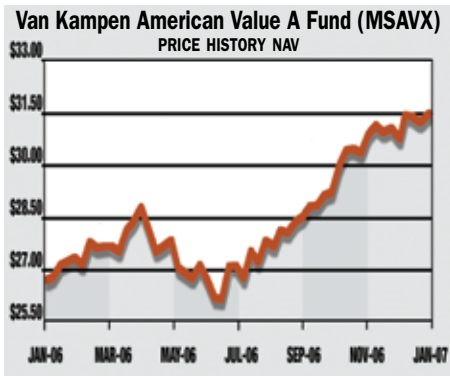
The other critical valuation that we use is return on capital. We are very



SERGIO MARCHELI is a member of the portfolio management team for the Van Kampen American Value Fund.

He joined Van Kampen in 1995 and has 11 years of industry experience. Sergio received a B.B.A. in 1997 from the University of Houston in Finance and received his M.B.A. from The University of St. Thomas.

“If the majority of analysts have a negative view or “sell” recommendation on a particular stock that we believe has attractive value characteristics, we definitely want to take a look at that company.”



big proponents of return on capital because the companies that continuously exhibit low returns on capital gradually destroy value over time, and we make sure to avoid them. We're looking for companies that have or historically had high return on capital. Even if currently they don't have the highest return, we are looking for a trend towards improvement.

Q: Do the companies with high return on capital fall into several industries?

A: Typically, companies with high return on capital are concentrated in specific industries; the pharmaceutical industry is a good example. There are very cyclical industries, for example commodities, which don't exhibit high returns on capital. When we evaluate those specific areas, we do it from a relative standpoint. We look at the historical returns and focus on the companies with high returns relative to their peers and on the companies with the ability to achieve high returns.

Other valuation measures include price-to-earnings and price-to-sales ratios. But when we use the P/E ratio, we use normalized earnings to compensate for the cyclical nature. We want to make sure that we strip out the times when the companies will be over or under earnings, as well as the times when anomalies occur. We usually go back at least 15 years to see what the normalized earnings have been over time. The normalized figure helps to see if the P/E is reasonable and if the company is undervalued. Based on that decision, we will determine

whether or not to continue to focus on the company.

Our fundamental analysis work starts with looking at the companies' financial statements. Once we've come up with a company that looks attractive, we'll talk to Wall Street analysts. We're not looking for their stock ideas or recommendations, but for gathering more detailed information on the company.

Meeting the management is another crucial element of our strategy. Whether at an in-person meeting, a conference call, or at an investment conference, we need to talk to the management prior to investing in the company. This is because we need to ensure that we're comfortable with the management and are confident that it can execute and lead it in the right direction. If we can't get that confidence, then we will not invest in the company.

But, before making the final investment within the company, we need to come up with a catalyst.

Q: Could you describe the type of catalysts that you look for?

A: We look for three different types of catalysts, but we don't necessarily need all three of them working at once; we're looking for at least one catalyst.

The first type is a fundamental change within the company, which is probably the easiest one to identify. We can see it through the income statements, the earnings growth, the margin improvement, and the efforts of the company to cut costs or to come out with a new product that's going to drive its revenues.

We look for a positive change within the company and we try to find an inflection point for that change. A company may be losing money, but if it is losing less money quarter over quarter, there is something going on. We want to make investments in such

companies before everyone else on the Street jumps on the bandwagon of that company's improvement.

The second catalyst is related to changes or consolidation within the industry. Usually, when an acquisition is announced within one industry, it creates a domino effect and other companies within that same industry start making acquisitions as well. In 2005 and 2006, for example, in the telecommunications industry there was the Sprint-Nextel merger; then Verizon and Quest Communications were battling out to take over the MCI assets. Later SBC acquired AT&T, then acquired Bell South. When there is rampant M&A activity like that, you can take advantage of the situation.

The third catalyst is a management change at the top level. We prefer outside changes, or when the company brings a CEO from the outside to move the company in a new direction or to change the company's attitudes. Sometimes an internal management change can be positive as well, but we're mostly trying to focus on outside changes.

Typically, the quickest catalyst to spot is a fundamental change, but there are times when you spot one catalyst, and the other catalysts tend to fall into place as well.

Q: Could you give us a couple of specific examples of how you get an idea and then turn it into a holding?

A: Our top holding is International Flavors and Fragrances, and represents 4.5% based on market value as of 9/30/06. We acquired the stock in the first quarter of 2005 and it has been a top performer in the portfolio. The company is a leading manufacturer of chemical compounds used to import flavor or fragrance to consumer products. They have market share of 17% in a \$12 billion market and 70% of their business comes from outside the United States.

The stock was attractive on an enterprise value-to-sales basis. It screened very well with EV/sales of 1.9, while the historic median was about 2.6. The return on capital is also very high at about 20%. It is a dominant player in its market, which had a few missteps in the businesses and the product line. There was a management change and they brought in a new CEO in July and have managed to increase the cost savings, to repurchase shares, and to decrease their debt. The stock has performed very well, up about 46% for the year.

Another example is ConAgra Foods, which is also one of our top 10 holdings. It represents 3.1% based on market value as of 9/30/06. We got involved in this stock in early 2006. The company is in the consumer food and ingredients businesses, with the bulk of their business in consumer foods. There was negative analyst sentiment on the company as it didn't spend a lot of money on brand advertising. Their products include TV dinners, popcorn, hot dogs, and beef type products, but their brands were recognized as B-rated type of brands. The return on capital was about 7%, while historically it was closer to 10%, so we saw room for improvement.

They brought in a new CEO in October 2005 who used to be the CEO of Pepsi Beverages and was responsible for building the Tropicana brand. He did a phenomenal job of turning Tropicana into the high-end brand of orange juice at Pepsi. We met him in early 2006 and he laid out a plan that included a strategy for building brand awareness for the products that they have. He started the process of making ConAgra Foods one of the well-known consumer food companies. In addition, he reduced corporate spending because, previously, the company had spent extravagantly on things like a corporate fleet of airplanes. The stock has done phenomenally well this year, up over 30%.


Q: How do you approach the portfolio construction process in terms of benchmarks, position sizes?

A: We compare ourselves to the Russell Mid Cap Value Index, but we screen a broader universe as we don't want the Mid Cap Value Index to dictate to us what a value stock is. The portfolio holds approximately 40 to 55 securities. When building positions, we start with initial sizes of 1.0% to 1.5%. Core positions run in the range of 1.5% to 2.5%, while high-conviction securities are in the range of 2.5% to 5%. We will never build a position up to 5% but we'd let it appreciate to 5%, which is our maximum position size.

When we reduce our holdings, we make sure to avoid the liquidity risk created by unloading the security. Because we're very cognizant of the liquidity issues, the selling process may take a little longer.

Q: What is your policy on risk management?

A: First, our portfolio is diversified across all the sectors and although we are bottom-up investors, we are mindful of the benchmark. Typically, we stay within 10 percentage points of the benchmark. We also strive to keep a cash position of 5% or less.

But the most important risk management is the focus on valuation and companies negatively viewed in the marketplace, and where a lot of the downside risk has already been taken out. That's risk management derived simply from the nature of our investment strategy. 

The opinions referenced above are for informational purposes only and are those of the fund's portfolio management team as of 12/20/06. They are subject to change at any time due to changes in market or economic conditions. The comments should not be construed as a recommendation of individual holdings, market sectors, and do not contend to address the financial objectives, situation or specific needs of any individual investor. They are intended to be an illustration of broader themes.

Van Kampen American Value A Fund

Symbol	MSAVX
Website	www.vankampen.com
Address	Van Kampen Investments Inc. 1221 Avenue Of The Americas New York NY 10020
Tel. No.	800-847-2424
Inception	10/18/93

PORTFOLIO	
Total Net Assets*	\$503.5
Avg Mkt Cap (\$ Weighted) *	\$5,800
Average Price/Earnings Ratio	25.71
Average Price/Book Ratio	3.82
Turnover Ratio	82%

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$1,000
Min Subsequent Investment	\$50
Min Initial IRA Investment	\$500

RISK (S&P 500)	
Alpha	0.23
Beta	1.16
R-Squared	0.84
Ann Std Deviation	8.72
Sharpe Ratio	1.34

RETURNS VS. RUSSELL MID-CAP VALUE INDEX		
	MSAVX	Index
1 Year (Cum.)	20.26%	12.27%
3 Year (Ann.)	15.46%	21.17%
5 Year (Ann.)	11.71%	16.63%

FEES AND EXPENSES	
Max Sales Charge - Front	5.75%
Max Sales Charge - Deferred	5.00%
Max Redemption Fee	2.00%
Total Expense Ratio	1.29% - A shares 2.04% - B, C shares

PORTFOLIO MANAGER	
James A. Gilligan	9-30-03
James O. Roeder	9-30-03
Thomas Bastian	9-30-03
Sergio Marcheli	9-30-03
Vince Vizachero	9-30-03
Thomas Copper	8-31-05

*millions

Data through: 12/31/06

Source: Company Documents; Lipper

Past performance is not a guarantee of future results.

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**