

## Mid-Cap Contrarian

*One of our core investment beliefs of Advance Capital I Equity Growth Fund is not to try to time the direction of the market and spread our investments across several companies. The portfolio manager Donald Peters uses a combination of quantitative models and fundamental bottom-up research to identify medium-sized growth companies with good businesses trading at reasonable valuations and own them for a long time.*

**Q: What is your investment philosophy?**

**A:** The essence of what we are trying to do is to search for companies to invest in and not be active trader. We try to identify good businesses at reasonable valuations and we tend to own them for a longer period of time.

One of our core investment beliefs is not to try to time the market direction. We are not looking to invest in a company with an immediate catalyst.

We believe that to generate consistent above market rate of returns with a concentrated portfolio is hard to do so we diversify our investment pool and make a series of decisions on a number of companies. Our approach is low risk with low volatility and spread investments across number of stocks.

**Q: What distinguishes you from your peers?**

**A:** Our time horizons are a lot longer than other Mid-Cap growth investors. We're investors – not traders. We try to find companies we think have strong business models and are good

businesses and trading at reasonable valuations. We tend to own them for a long time and our turnover in the portfolio is about 30% compared to 100% in mid cap fund category. One of the interesting aspects of our turnover rate is that a lot of that turnover can be from selling winners that have exceeded market cap range in the mid cap sector.

**Q: How would you describe your investment process?**

**A:** First, it is a combination of quantitative techniques and fundamental insights of our analysts at T. Rowe Price. When you're investing in Mid-Cap companies, you're investing in companies that are relatively early in their life cycle so that one should expect the reasonably high failure rate. External events have a greater impact on mid cap stocks than in the larger caps.

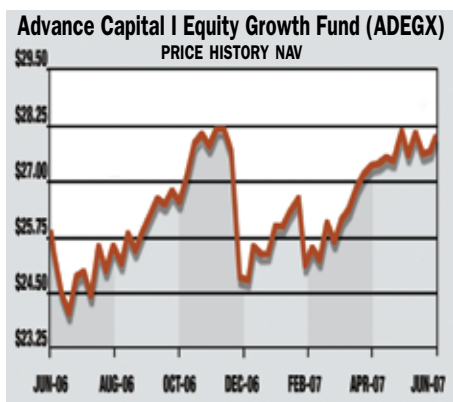
We use quantitative measures based on fundamentals. We are looking at one company at a time. We use industry and company knowledge of our research analysts and look for



**DON PETERS** is a Vice President of T. Rowe Price Group, Inc., and T. Rowe Price Associates, Inc., and a Portfolio Manager in the Equity Division. He is a portfolio manager for major institutional relationships with T. Rowe Group, Inc. structured active and tax-efficient strategies and the Diversified Mid-Cap Growth Fund, Tax-Efficient Growth Fund, Tax-Efficient Multi-Cap Growth Fund and the equity portion of the Tax-Efficient Balanced Fund.

Prior to joining the firm in 1993, Peters was a Portfolio Manager for Geewax, Terker and Company. He is a former naval officer and was interviewed and selected by Admiral Hyman G. Rickover to work on his headquarters staff for the Navy's nuclear propulsion program.

Peters earned a B.A., summa cum laude, in Economics from Tulane University and an M.B.A. in Finance from the Wharton School, University of Pennsylvania.



companies that have consistent earnings growth and operating cash flows. We use quantitative tools to measure and control allocation risk. Our contrarian views helps us in avoiding latest investors fades and seek values in sectors or companies that are out of favor.

We have no views with respect to the direction of the market. We look at how a security has been priced through time and try to find those companies that are attractively valued or at least reasonably valued for the longer-term investment hypothesis that we have.

**Q: How many stocks do you generally have in the portfolio?**

**A:** We believe in diversification so we'll own between 275 and 325 stocks. We are making lots of individual decisions that constitute modest position in the portfolio.

We believe that we are compensated for taking a higher than normal level of risk. Generally, the largest weight in the portfolio will be about 1%. Or, to put it another way, when we have a company that does not perform as we hoped, it won't kill the portfolio or our relative performance – the loss will be minor and manageable. We take a contrarian approach to look at sectors and companies where stocks have underperformed over the last several years.

**Q: What are the criteria you follow before you buy a company?**

**A:** We structure the portfolio to have less volatility than the benchmark. I think having market-leading companies with solid management teams and good cash flow goes a long way in protecting portfolio when markets hit a sustained downturn. That's not to say in bear markets we don't fall in value or lose money. We tend to lose a lot less than others.

We tend not to invest in companies with lot of debt on balance sheet. We are looking for companies with consistent earnings growth that is generally associated with good free-cash flow and the market leading position in various niches which are anticipated to grow.

One of the interesting things we care a lot about relative to most mid-cap growth investors is we actually like dividends. One of the things that we are worried about are those companies that do seem to have an inappropriate capital structure that usually leads to bad things such as investing in projects that don't have good returns and even worse, merger and acquisition activity.

We use the industry and company knowledge of our research analysts and look for companies that have consistent earnings growth and operating cash flows. We use quantitative tools to measure and control allocation risk. Our contrarian views helps us in avoiding latest investors fades and seek values in sectors or companies that are out of favor.

**Q: What drives your sell decisions?**

**A:** The biggest reason to sell a stock is when the fundamentals are a disappointment relative to what we had expected. We will also sell a position when we think the valuation on a relative basis has gotten a bit beyond reasonable, but that tends to be infrequent. We will also sell for market capitalization reasons.

**Q: How diversified are you across the different industries and sectors?**

**A:** When it comes to sector diversification, we tend to take a bit of a contrarian approach to look at those areas where stocks underperformed over the last several years.

**“One of our core investment beliefs is not to try to time the direction of the market. We are not trying to predict the possibility for some catalyst that's going to make the stock work immediately.”**

For example, we are overweight in the technology sector which has been a dreadful performer over the last five years; we are overweight in the healthcare sector – again one of the worst performers over the last five years.

Mining and energy sectors have done well over that same time span and we are underweight in those sectors as we tend to avoid commodity-oriented businesses. We view the usually large weights these sectors have in the Russell Mid Cap Growth Index as a contrary indicator and generally we use this as a signal to underweight stocks in that sector.

**Q: Could you use some examples to illustrate your buy and sell process?**

**A:** We are overweight is in the semiconductor space. We have owned companies like Linear Technology, Xilinx, Inc, Altera Corp, and Broadcom. For a long period of time these companies have gone through the worst of an inventory cycle but they all remain very solid businesses with attractive gross margins and cash flow characteristics. We are very encouraged with respect to what Linear has done regarding addressing an over-capitalized company and significantly reducing shares outstanding, and it's paid a steady dividend through time. The fact that you can get a 2% yield and buy these fabulous businesses at reasonable multiple trading the near trough of an inventory correction is a wonderful opportunity.

Charles Schwab & Co. and Adobe Systems are two stocks which we have recently eliminated. We purchased them when they were once valued as large cap companies and had fallen into the mid-cap growth zone for various short-term reasons. These companies had just fallen out of favor but we thought they were both offered

tremendous franchises that were out of favor. We eliminated them primarily for one reason that their market capitalization had exceeded \$25 billion.

**Q: What kinds of risk do you monitor and what do you do to mitigate them?**

**A:** We use a lot of quantitative factors to first understand the risk that we have in a portfolio. We structure the portfolio to have less volatility than the benchmark and having market-leading companies with solid management teams and good cash flow goes a long way in doing that at the micro-level. That's not to say in bear markets portfolio will not fall in value or lose money. But in the downturn we tend to lose a lot less relative to others and our benchmark.

Consistency is the key to long-term success. We take a lower volatility and lower risk approach. What we really try to do is provide good risk control for patient investors. There is risk in every investment. But our analysis significantly reduces the risk while providing consistent gains over time.

We've tried to be consistently better than average fund through time, but not take a huge amount of risk to accomplish that. ■■

## Advance Capital I Equity Growth Fund

Symbol	<b>ADEGX</b>
Website	<a href="http://www.advancecapitalonline.com">www.advancecapitalonline.com</a>
Address	Advance Capital Management Inc One Towne Square Suite 444 Southfield, MI 48076
Tel. No.	800-345-4783
Inception	08/05/1987

### PORTFOLIO

Total Net Assets*	\$226.8
Avg Mkt Cap (\$ Weighted)*	\$8,400
Average Price/Earnings Ratio	28.28x
Average Price/Book Ratio	5.86x
Turnover Ratio	38%

### INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$10,000
Min Subsequent Investment	N/A
Min Initial IRA Investment	\$2,000

### RISK (AGAINST S&P 500 DAILY REINV INDEX - 3 Y)

Alpha	-0.24
Beta	1.34
R-Squared	0.78
Ann. Std Deviation	11.07
Sharpe Ratio	0.80

### RETURNS VS. S&P 500 DAILY REINV INDEX

	ADEGX	Index
1 Year (Cum.)	19.76%	20.59%
3 Year (Ann.)	12.70%	11.68%
5 Year (Ann.)	13.12%	10.71%

### RETURNS VS. RUSSELL MID CP GRO TR INDEX

	ADEGX	Index
1 Year (Cum.)	19.76%	19.73%
3 Year (Ann.)	12.70%	14.48%
5 Year (Ann.)	13.12%	15.45%

### FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	1.01%

### PORTFOLIO MANAGER

Donald J Peters	12/29/1993
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\*millions

Data through: 06/30/07

Source: Company Documents; Lipper

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