

Largest Cap Values

Back in 1995 the idea was to design a value fund that is suitable even for the most risk-averse investor. The result is the Ameristock Mutual Fund, which invests in 39 largest-cap stocks and household names that are profitable, pay dividends, and have solid business fundamentals. The manager Nicholas Gerber relies on a bottom-up selection process and fundamental analysis to hand-pick the right companies in the right industry dynamics.

Q: What's the underlying philosophy of the Ameristock Mutual Fund?

A: It is a large-cap value fund that invests in large and well-known companies. There is no company in the fund that you wouldn't recognize immediately, or whose products your neighbors don't use. Overall, this is a fund suitable for investors who want to participate in the market without taking all the risks the market sometimes throws at us. We established the fund in 1995 as a no-load, large-cap, domestic value fund that invests in the largest of the large-cap companies.

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

A: Our universe consists of about 220 companies with market capitalization of more than \$15 billion. We research each one of those companies with a fundamental, bottom-up approach. There is no black box in our process. We stick to a business model analysis, which involves assessing not only the company, but also its competitors, substitutes, suppliers, customers, and how all these elements affect its economic mode.

Overall, we like dividends because they are easy to value. We like retained earnings,

especially if the return on the retained earnings is higher within the company than outside of the company. For example, General Motors exhibits a high level of retained earnings, but the return on these earnings would be greater if they had bought T-Bills. We also like growing sales over time and seeing a company actually hiring people. Since an employee represents a high long-term fixed cost, a CEO who is willing to hire people or to invest in machinery, tells us that he believes in the long-term prospects of his company.

The process of fundamental screening brings down the universe of 220 large companies to about 30 eligible names. Then we divide the companies that we actually want in the portfolio into three buckets: relatively undervalued, fairly valued, and good names that are relatively overvalued to the rest of the portfolio. That division is very important in the portfolio construction process as it determines the initial weight of each company.

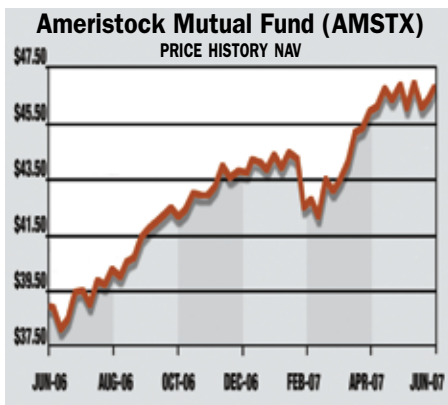
Each of the companies that we consider relatively undervalued is assigned about 4% of the portfolio each; the fairly valued companies get 2% each; and the relatively overvalued names get 0.5% weighting. For example, we have always owned Microsoft



NICHOLAS D. GERBER Ameristock founder co-manages the Ameristock Mutual Fund. Prior to establishing Ameristock, Gerber served as a portfolio manager with Bank of America Capital Management, where he was responsible for the daily stewardship of four funds with a combined value in excess of \$240 million.

Before joining Bank of America, Gerber was Managing Director of the Marc Stevens Futures Index Fund. It was there that he created and managed a futures index fund that was ultimately purchased by Newport Commodities.

Gerber's two decades of experience in institutional investment include a successful stint as a floor trader on the New York Futures Exchange. Gerber holds an MBA in finance from the University of San Francisco and a BA from Skidmore College.



but for years it has been in the bucket with 0.5% weight because it was expensive. Everyone knows that it is a great name and a natural monopoly, so it is not a cheap stock. On the other hand, it's not a company that we did not want to own.

Q: Could you give us some specific examples that illustrate your thought process?

A: Our longest-term holding at top weighting, and one of my favorite companies, is Sara Lee. We have owned that stock for a number of years, even before Brenda Barnes became the CEO and decided to restructure the firm. They did several spin-offs and brand sell-offs before deciding to sell other European businesses and brands and to consolidate the manufacturing and R&D activities in Chicago. We like her business plan. More importantly, she has done everything that she has told us she would do and within the time lines presented.

Her ultimate plan for the company is to own a number of billion-dollar market leading

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brands, such as Kiwi, Sara Lee, Hillshire Farms, and Jimmy Dean, and to combine them into different new products. It is a very good strategy and we look forward to seeing it unwind over the next few years. Now she has reached the phase when there is no more talking, cutting back, and selling assets off. The restructuring begins to affect the top-line growth, and that the trend should accelerate over the next two or three years.

Q: When such turnarounds happen, would you sell the stock or you would continue to hold it?

A: In the case of Sara Lee, we would continue to hold it as long as the market capitalization was above the fifteen-billion mark and it still had relative value. Staying true to our style is important. I believe that this is what the advisors and the investors want from us. We don't sell performance; we sell process and trust to those who want market participation with less risk. If the advisors know that they can trust us and our process, then they would consider this to be a good fund for the investors who want marketing participations with less risk.

Q: Would you explain in more detail the research process that enables you to find such companies?

A: It is a bottom-up, fundamental research process. After all, we are not researching Indonesian gold mines and we don't have to go to Indonesia and tramp through the jungle. All the companies in our universe are researched by at least 10 other people, so we look at their annual and quarterly reports, read the industry magazines, visit the stores and the competition.

We don't necessarily talk to the management because we have found that what they say is not always reliable, and because these companies are so big that in most cases the management doesn't have huge effect on the business itself. For many of these companies, the momentum goes by itself and it doesn't really matter who is in charge. The company ei-

ther has a wide reach and strong brands, or it doesn't. If a CEO is doing poorly, the board will replace him. Nowadays the CEOs are expected not only to meet the quarterly numbers, but also to be able to add value to the business in the long run.

Q: How do you approach the portfolio construction process? Do you have any benchmarks?

A: No, we don't follow any index. Of course, we would compare our returns to different indexes, as well as our overweights and underweights to specific industries. But we rely on a fundamental, bottom-up approach to construct the portfolio. Our exposure doesn't have to be within a range that depends on the S&P index. For example, during the dot-com boom, the S&P became in essence a technology index, with exposure of 35% in technology. At the same time we had about 35% of our portfolio in financial services because that was the most undervalued place to be from a bottom-up perspective.

We have certain portfolio rules, such as a limit of 5% on individual securities. I believe that if you hold securities beyond that level, you would no longer manage a diversified fund. Shareholders owe taxes and you also have to think about SEC laws. So our exposure of 4% for the undervalued stocks gets us as close as possible to that level without taking additional risks. It is also important to note that our top 10 or 15 companies are all at 4% exposure.

Overall, we hold 39 names in the fund and their weightings vary depending on the type of company and its valuation. Because of our philosophy, we end up investing in the largest of the large-cap companies. The average market capitalization of the companies in our fund is about twice the market capitalization of the S&P 500. I believe that the S&P 500 median market cap is \$35 billion, while ours is about \$65 billion.

It is also important to emphasize the long-term focus that we have. Our average

turnover ratio is about 10%, which is exceptionally low for the industry. The companies move from bucket to bucket, but within a year, we would probably replace only three companies.

Q: Do you also restrict your exposure to sectors and industries?

A: No, our sector exposure is a function of the individual stock selection process. Theoretically, we can select 39 stocks in the same sector but that really wouldn't be good portfolio management. Nevertheless, we have the freedom to do it by prospectus. Similarly, we have the freedom to invest in futures and options but we've never done that.

Q: Would you consider investing in ADRs of large-cap international companies if they come up in your universe of 220 companies?

A: Yes, we have considered some ADRs. We have looked at Toyota when we sold Ford and General Motors. We do own British Petroleum because we have owned Amoco years ago. Overall, if we find an attractive ADR that meets all our criteria, we would probably add it. But our mandate is to be in domestic companies, so a couple of foreign names would be an exception rather than a rule. Investing in them would be only because we couldn't find something domestic that was better.

Q: What type of risk control measures do you have, in addition to the diversification and the limits on individual positions?

A: We like companies that are profitable and pay dividends. That approach definitely helps on the downside and that's how most investors perceive risk. Overall, investors like to make money, but they certainly hate to lose it. The high dividend yield helps to absorb some of the shock that you sometimes see on the downside.


But our most important risk control measures are diversification, fundamental screening, and good old-fashioned analysis. It is crucial that we approach the

stocks as businesses. I believe that we should understand the businesses and buy them for the long run. If you just treat them as stocks, you'll hurt the total return of the fund because every time you buy and sell a stock, you pay brokerage commissions and taxes. Minimizing these significant costs is another way to manage risks.

Q: What would be your approach towards large companies like GM, which is paying high dividends but doesn't necessarily have the best management or strategy? Another example is a company like Kodak, whose stock has been a challenge.

A: We don't own GM or similar companies because the fundamental screening takes them out. Regarding Kodak, we used to own the stock when we started the fund in 1995. It was also one of the first companies to sell because we saw through the business model analysis that its business was changing. The business was no longer about films but also about digital products. And while we thought that they would cope with the transformation and survive, we also acknowledged that their market share was not likely to stay at 80%. Moreover, the margins in electronics industry are much thinner than in the film industry.

When this phenomenon began to take place, we sold out our Eastman Kodak stock. Having in mind that our investors are risk averse, we saw no reason to own Kodak during the transformation of the industry. We have owned it, and if it copes well with the industry dynamics, we may own it again in the future. But we would rather stay on the sidelines during this risky period.

On the other hand, Sara Lee is also going through a change, but this is a self-imposed change that is going to make the company stronger at the end. It's not a change that's dictated by the market and competitors like Canon and Sony. Sara Lee doesn't have to be reactive, it can be proactive. 

Ameristock Mutual Fund

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Tel. No.	800-394-5064
Inception	08/31/1995

PORTFOLIO

Total Net Assets*	\$523.5
Avg Mkt Cap (\$ Weighted)*	\$108,700
Average Price/Earnings Ratio	18.68x
Average Price/Book Ratio	4.16x
Turnover Ratio	10%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$1,000
Min Subsequent Investment	\$100
Min Initial IRA Investment	N/A

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

Alpha	-0.05
Beta	0.79
R-Squared	0.77
Ann. Std Deviation	6.54
Sharpe Ratio	0.72

RETURNS VS. S&P 500 DAILY REINV INDEX

	AMSTX	Index
1 Year (Cum.)	18.88%	20.59%
3 Year (Ann.)	8.45%	11.68%
5 Year (Ann.)	6.99%	10.71%

RETURNS VS. RUSSELL MID CP GRO TR INDEX

	AMSTX	Index
1 Year (Cum.)	18.88%	19.53%
3 Year (Ann.)	8.45%	7.74%
5 Year (Ann.)	6.99%	7.17%

FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	0.79%

PORTFOLIO MANAGER

Nicholas Gerber	08/31/1995
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*millions

Data through: 06/30/07

Source: Company Documents; Lipper

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