

Economically Independent

According to the investment philosophy of the Vice Fund there are four major sectors that tend to be defensive in nature and immune to macro economic events and they are Tobacco, Alcoholic Beverages, Gaming and Aerospace Defense. Taking advantage of this fact, portfolio manager Charles Norton is looking for the best opportunities within both domestic and international companies in these sectors to diversify away from the U.S. economy.

Q: What is your investment philosophy?

A: We focus on four sectors - Tobacco, Alcoholic Beverages, Gaming and Aerospace Defense. We believe that these sectors tend to be defensive in nature and immune to macro economic events. Therefore, they tend to outperform during both economic and market downturns and we are searching for stocks that can sustain their growth regardless of the economic cycles.

Our approach is global and we aim to find the best opportunities within both domestic and international companies in these sectors to diversify away from the U.S. economy.

Q: What are the macro trends that drive those sectors?

A: On one end of the spectrum we have Tobacco, Alcoholic Beverages and Aerospace Defense which tend to have less volatility relative to the market and high dividend yield. On the opposite end, we have the Gaming sector, which is high growth, very high beta, but no dividends. That complements what we are doing and helps us in up and down markets.

In the tobacco sector currently the domestic litigation risk environment has improved tremendously from that of the past decade. For a long time no foreign cigarette company entered the U.S. market, for fear of legal risk. However, earlier this

year Imperial Tobacco bought the number four U.S. cigarette maker, one of the first instances of an entry by a foreign company in the past decade.

At the same time, despite the smoking bans, the companies have tremendous pricing power and are able to offset those declining volumes by increasing their prices. They are hugely profitable and pay good dividends. Furthermore, the litigation and the smoking bans being limited to the domestic and to some degree Western Europe, there are huge growth opportunities around the world. Right now, a wave of consolidation is underway in the industry. Strategic buyers are driving this wave, which will ultimately leave only a handful of players. There are also growth opportunities in smaller categories like moist smokeless tobacco.

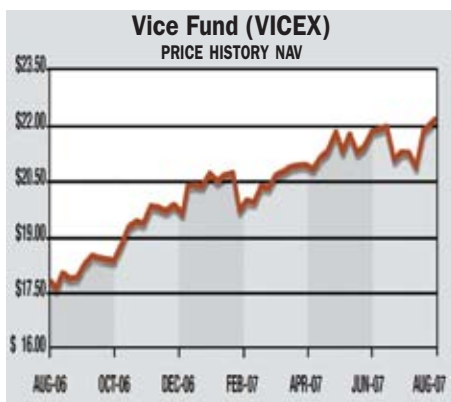
As for the gaming sector, we see continued strength in Las Vegas by all metrics - visitation, gaming revenue and the value of land on the near gaming locations is astronomical. Gaming is the real American pastime with people spending more than on movies, videos, music and books combined. Except for Utah and Hawaii, every U.S. state has some sort of legalized gaming. The Government is a very big beneficiary in gaming. The states receive millions of dollars annually from gaming tax revenue to go towards public development. The same is true for the tobacco sector.



CHARLES L. NORTON CFA, is a principal of GNI Capital, responsible for portfolio management and investment research for all of the company's managed assets, including the Vice Fund (VICEX). In addition, he is a regular contributor for RealMoney.com, a financial website published by TheStreet.com, and his columns frequently appear on Yahoo! Finance and MSN Money.

Previously, Norton had been a Vice President in the Equity Research Department of Gotham Capital Management, a New York-based hedge fund, where he also managed separate long/short equity accounts. Prior to his experience on the buy side, Norton worked in the investment banking division of Smith Barney, where he was an analyst in the Health Care Group, reporting directly to the head of the group.

Norton has a Bachelor of Science in Management degree in Finance from Tulane University's A.B. Freeman School of Business, and is a CFA charterholder. He is a member of the CFA Institute and the CFA Society of Dallas-Fort Worth.



Business in general is expanding and we are extremely excited about activities in Asia and Singapore. In Macau there was a monopoly until 2004 when Las Vegas Sands came in, and in two short years they surpassed the revenue of Las Vegas. Singapore is coming online in 2009 and Japan, India, Thailand, all of Asia is beginning to embrace casino gaming. That is going to create a huge opportunity for the casino operators over the next few decades.

Another area of this sector that we like is the gaming equipment companies, like International Gaming and Technology and WMS, because there's a major replacement cycle right around the corner. It is starting in 2009 and will be driven by a new technology called Server Based Gaming thus creating a big opportunity for the gaming equipment suppliers.

Consolidation too is an important development. In the tobacco sector it's being driven by strategic buyers and in the gaming sector it is from financial buyers. There have been five major complete buyouts since the beginning of 2006. Thus,

“Nearly 30% of our fund's capital is invested in international companies, a fact that further desensitizes the portfolio from US macro events and market plays given the inherent defensive nature of the four sectors.”

two of four sectors are consolidating, one through strategic buyers and one from financial buyers.

In the alcoholic beverage and beer sector we are seeing the most robust growth in the U.S. in super premium spirits category. We identify companies that are likely to benefit by looking at how they are positioned versus their competitors. We see the greatest growth opportunities for brewers in the emerging markets, more specifically Central and Eastern Europe, Asia-Pacific, Africa and the Middle East and Latin America that are the fastest growing beer markets in the world. Meanwhile, in the U.S., and even Western Europe their domestic beer markets are struggling with little or no growth, exceptions being Kraft Beers and Imports. That is the overlying trend within that sector.

We see defense stocks as cyclical but not tied to economic cycles as much as budgetary cycles and therefore they outperform the broad market when Defense Department budgetary authority is increasing. We think that at least for the next few years, the defense budget will continue to be on the rise. Right now, there are another two or three years left in this sector. The threat levels remain high; the defense programs are more integrated now than they ever have been before.

We see favorable trends in the commercial aerospace industry. In the 60s, commercial aerospace demand came from just the U.S. and Europe, and those two moved in tandem, so there was some strong cyclical behavior within the sector. A third area of demand is coming from Asia and the Middle East. This implies that the peaks and troughs in the cycles will be a little smoother, though not as deep, and also the cycles are going to last longer. Currently we are in an extended up-cycle in commercial aerospace demand that will last until about 2011.

Q: Could you highlight your research process?

A: We do intensive research at both the industry and company levels. Within each of these four sectors we develop an extensive, macro-level view of the happenings

and where the opportunities lie. We then do company-specific research and try to identify those that stand to gain the most within that broader framework and ones that are not going to do well too, because not every company will benefit from the overlying trends that are going on within the industry. Therefore, we seek to take advantage of that fact by taking a long-term approach in investing in companies that will benefit over many years, from the trends that we see, and selectively sell short companies that will be on the losing end.

Q: Could you illustrate your research process with some examples?

A: Boeing fits into our portfolio and fits in with our position in the commercial aerospace cycle. We think we are mid-cycle with another few good years left so it meets the first criteria of a fitting with a beneficiary of our bigger picture macro theme. Boeing is a new product cycle story, with the Dreamliner 787. So here you have both a bigger picture macro theme as well as a real company specific driver that we think will be huge.

The 787 is Boeing's most successful product launch ever, and the company has taken a very different approach. The development and production processes are different, the results of which will be significantly higher margins, especially as R&D costs decline over the next few years and the whole cycle is much more refined and shortened now. They've got well over 700 orders and as they start to recognize that revenue and as the R&D figures decline over time, their margins are set to expand and so we think that there is a 30% upside in Boeing over the next 12 to 18 months.

Q: Can you give an example of a company you are now short on?

A: The moist smokeless tobacco niche is a pocket of tremendous growth, especially as smoking bans continue and cigarette makers are agog as to what is going on in this segment. UST was the leader in this arena with 60% market share. In April '06, Reynolds American bought the number two player, a private company called Conwood and they paid \$3.5 billion for it. After that deal, we went long on UST in the mid-\$40

price range thinking that it would also be bought and if you put the same multiples that Reynolds paid for Conwood, one could get huge numbers for UST. Therefore, we rode UST from the mid-\$40s to the low to mid-\$50s, at which point we exited and we are now short.

UST operates in super premium end of the moist smokeless tobacco category hence their Copenhagen and Skoal brands are north of \$4 dollars a can. However, the real growth in this sector is the discount side where Conwood operates, where growth has been off the charts. UST has been losing market share, slowly and steadily, at the expense of the discount end of the category. There is this pricing gap between the positions of UST and Conwood and more so because of the nature of the taxes that are based on price not by weight; hence UST's can of Copenhagen is taxed higher than a can of Conwood's Grizzly. We believe this major pricing gap has to be resolved at some point, especially as consumers are trading down in that category.

For a long time it was felt the situation could be salvaged as people thought the giant Altria would buy UST, and if they didn't, they would come out with a Marlboro branded product at the premium end, where UST is. This would support and bring back growth to the premium end of moist smokeless tobacco, and also use the Altria political power to try and get the tax structure changed to be based on weight rather than price, which would help alleviate some of that pricing gap. Recently, Altria tobacco unit, Philip Morris USA, announced the test launch of a Marlboro branded moist smokeless tobacco product in the Atlanta market. If successful, it would be rolled out nationally at \$3 a can. This also means a potential suitor has turned into a fierce competitor. They undercut where Copenhagen and Skoal are currently trading by about 40% to 50%, and so there is tremendous pricing pressure now on UST, eventually to come down and match Marlboro or risk losing more share.

Q: How do you go about portfolio construction?

A: Generally, at any given time, the number


of stocks in the portfolio on the long side, could be between 30 and 50, and on the short side, much less. So overall, we are probably below or between 50 stocks or 60 stocks. The turnover in the fund could be 44% but ultimately, our goal is to make as much money for our shareholders as we can.

Unlike other managers of other sectors, we do not have to be, and we are not, bullish on each of these four sectors all the time. Our job is to be experts in these sectors and if something warns us from a bigger picture view, causing a concern for us, we will not have exposure there. Our requirement on aggregate is that our fund has to be 80% invested into the four of them combined but we do not have to own all four of them all the time.

Q: What is your buy and sell discipline?

A: As for buy discipline, first, based on the EBIDTA, we must believe a company currently fits within the directional move of the industry. Secondly, it must compete with existing ideas. We will not continually add more ideas to the portfolio as we feel that there is not very much value in a manager that has 200 stocks.

For instance, when we are making an investment in brewers, we find those that have the most exposure to the fastest growing beer markets in the world, and the least US exposure because of macro dynamics in the domestic market. Most of the international exposure overall in the fund, comes from this sector.

We will generally sell a company for two reasons: one is if the bigger picture industry view starts to change, which would then result in a shuffling of all of our companies, because they are currently positioned based on one industry view. Generally, however, this view changes very slowly, because these are trends we see developing over many quarters or years. Secondly, we would sell a stock if on the company-specific level it just does not live up to our expectations. A third reason is of a defensive nature - if there is something concerning us in the overall market and we are trying to raise cash. 

Vice Fund

Symbol	VICEX
Website	www.vicfund.com
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Tel. No.	866-264-8783
Inception	08/30/2002

PORTFOLIO

Total Net Assets*	\$124
Avg Mkt Cap (\$ Weighted)*	\$34,500
Average Price/Earnings Ratio	20.34x
Average Price/Book Ratio	6.52x
Turnover Ratio	67%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$4,000
Min Subsequent Investment	\$100
Min Initial IRA Investment	N/A

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

Alpha	0.44
Beta	1.07
R-Squared	0.66
Ann. Std Deviation	9.68
Sharpe Ratio	1.43

RETURNS VS. S&P 500 DAILY REINV INDEX

	VICEX	Index
1 Year (Cum.)	25.06%	15.13%
3 Year (Ann.)	20.89%	12.16%
5 Year (Ann.)	18.10%	12.00%

RETURNS VS. RUSSELL MID CP TR INDEX

	VICEX	Index
1 Year (Cum.)	25.06%	16.18%
3 Year (Ann.)	20.89%	17.33%
5 Year (Ann.)	18.10%	17.82%

FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee**	1.00%
Total Expense Ratio	1.75%

PORTFOLIO MANAGER

Charles L. Norton	2005
Allen R. Gillespie	2006

*millions **within two months of purchase

Data through: 08/31/2007

Source: Company Documents; Lipper

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