

Bottom-Up Discipline

Investing in large cap stocks with a view to achieving higher long-term values requires a great deal of company, sector and industry insight. The portfolio construction team along with the 25-member team of analysts of the US Large Cap Value Equity strategy rely on intense research to reach fair values of companies in their universe and identify investments that will bring increased total returns in the long term.

Q: What is your investment philosophy?

A: Our philosophy is based on the belief that investing in companies trading below their intrinsic value should help us generate wealth through long term investing. For us, this is not a new approach, this is an approach we have employed for the last 25 years in managing our institutional clients' assets.

Therefore, we focus on long-term value from our investments and do not screen short term metrics such as price-to-earnings, price-to-book, enterprise value or EBITDA. We look to invest predominantly in large cap companies and use a discounted cash methodology to identify them. We generally invest in stocks that at the time of purchase are contained in our benchmark Russell 1000 Value Index.

Q: What is your investment strategy and process?

A: Our investing universe is predominantly large cap companies having a market cap of at least \$ 3 billion—we generally invest 70% of the portfolio's assets in them. We also look to invest 30% in mid cap stocks within the Rus-

sell 1000 Value Index that fall between the \$3 billion and \$10 billion market cap.

Ours is a bottom-up investment process. An important aspect is that it is very research driven and totally dependent on the quality of our research. Our analysts' job is not to pick stocks, instead, through intense research, they must put values on companies and also provide thorough insights into their operations.

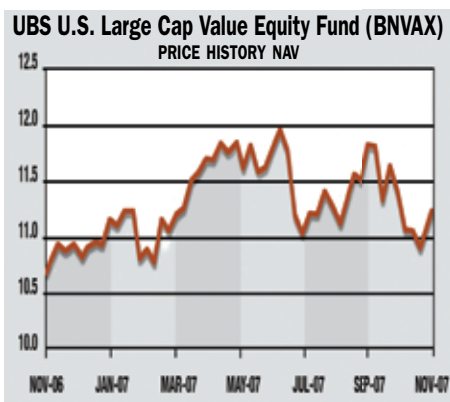
The analysts' valuations help us identify attractive investment opportunities in stocks with price-to-intrinsic value discrepancies. We use a discounted cash methodology to do this as we look at every business as though we're a cash buyer of the business and try to determine its intrinsic value. Basically, we take a normalized earnings approach and discount it to the present to find out the true value of the business.

This approach keeps us from being overly optimistic at the top of a cycle and from being over pessimistic at the bottom of a cycle. Our ultimate goal is to maximize our total returns in the



TOM DIGENAN participates in the analysis and development of US equity portfolios. He is also responsible for communicating the firm's equity strategy to clients and investment consultants. Previously, Digenan was president of the firm's mutual funds and relationship funds organization.

Prior to joining UBS in 1993, Digenan was a senior manager in the tax department of KPMG Peat Marwick, where he worked exclusively in the investment services industry. He is a member of the CFA Institute, the CFA Society of Chicago, and the American Institute of Certified Public Accountants.



long run. Consequently, we don't get caught in the game of trying to anticipate short-term price movements.

Q: What is your research process?

A: Our investment decisions depend totally on the best ideas and insights from our team of 25 analysts. This team is headed by Tom Cole, our research director who really pushes and gets us focused on the long term and what really matters in terms of valuation.

In terms of the prioritization of the research process, it's industry first and company second. We believe that to value a business, it is vital to understand its industry. In fact, sometimes the best stock ideas are byproducts of the information gathered at the industry level. Our analysts do thorough

“Our 25-year time-tested philosophy is based on the belief that investing in companies trading at a variance to their intrinsic value should help us capture the long-term arbitrage that comes into play when the stock price moves up or down towards its fair value over the long run.”

industry reviews. For our “typical” analyst, this is a career position as they develop into industry and sector-specific experts over time.

Each analyst thus focuses on a specific industry or sector. Stability is important as we depend on these people that believe in the process and do research with sincerity. For example, over the past seven years, only three senior analysts have left the firm and two of those were due to retirement. Our analysts are therefore embedding themselves in the industry; they are not waiting for the sell side to tell them about the quarter.

In terms of an idea or a holding, it is really one stock, and one idea at a time. This is because new ideas are very iterative in nature. At the time we are putting together the portfolio, we often get new buy ideas, especially when we meet different analysts. The same idea can come from different sources, from a different sector or analyst.

Finally, and the most important aspect of our research is that our analysts have to build and have a thesis for every stock they cover in which we're taking a position. This may be around three to five pages and must contain answers to questions like, what do we think we know about this stock and also what do we know that the market doesn't know and why is the stock mispriced? If the analyst values a stock at \$100 and the market price is at \$50 but cannot tell us what he knows that the market doesn't know, then maybe the market is right. So, we really have to have some fundamental concrete examples of what we believe in terms of strength in the fundamentals that the market doesn't see.

Q: Can you give examples that explain the thinking behind your selection process?

A: Basically the three reasons that

guide our buying decisions are: first, the obvious price-to-intrinsic value discrepancy; second, if we know something about the stock that prompts us not to buy it; and thirdly, something that we do not know that again tells us to avoid that stock.

For example, and this is kind of extreme, there was a company that is in the business of testing computer software. Around late 2005 the company got delisted because of some serious internal control problems. They weren't filing their financials on time. Their CEO and CFO had resigned; in fact they had real shake-ups in their top management that according to us denotes a thesis violation. They suffered large financial losses. Therefore that company started to get priced like they were going into bankruptcy. Now this was also during the years 2000 to 2004 where anything with an accounting issue just got hammered because there were so many accounting shenanigans, the company's stock suffered for lack of investors' confidence.

But the analyst covering that industry discovered they had a huge footprint in that space, a viable space in an industry that was actually growing. Hence the underlying fundamentals of the industry and the business were stronger than the stock price will suggest. Therefore, despite some real accounting issues, we found the company very attractive. Therefore, that was a company we were able to take a good sized position in because basically, the market shunned it.

Q: How is your portfolio constructed? What is the average holding time of the stocks?

A: We have companies with market caps of \$2 billion and higher. Allocation in our portfolio is normally about 70% large cap and 30% mid cap. At any point of time our portfolio has

about 50 to 70 stocks. A big industry bet would be weighted around 5% of the overall portfolio and a maximum would be about 12-1/2%. And since we do not screen for price-to-earnings, price-to-book and other metrics, our investment universe for the portfolio is basically the Russell 1000 Value Index.

Historically, the average holding time has been around two to three years because our turnover has been between 30% and 50%. However, at the time of buying we do not decide on any sort of holding time.

Q: How do you weigh stocks in the portfolio and what is your buy and sell discipline?

A: Our main aim is to overweight underpriced stocks therefore we need to find a significant price to intrinsic value discrepancy, especially if we are going to take a long position in a stock. If we think the intrinsic value of the company is 100 and it's trading at 100 we will not buy that stock even if it's a huge component of the index. Furthermore, to buy a stock, we also need a high level of conviction.


Moreover, the thesis built by our analysts for each stock in our portfolio should have specific, objective and measurable signposts that will reveal if the thesis is still intact on the stocks being held at a certain point of time. This is because, of the 50-70 stocks in the portfolio, there may be five or six holdings where the fundamentals have changed, or an error had been made in buying them in the first place, maybe a model error or incorrect assumption. These important signposts thus help us identify a thesis violation, whereby the underlying rationale or reason we originally bought the stock no longer exists. Once the stock is in the portfolio, our analysts also continuously reevaluate these signposts that lead to sell decisions.

Our sell discipline is therefore basically two-fold. One, when as a stock moves towards its fair value we want to reduce that investment and second, when we identify a thesis violation. If over time, a lot of our sell decisions are a result of a thesis violation that means probably our initial assumptions on the stock were wrong, but by having the thesis violation in place we can identify our mistakes.

Q: What is your view on risk and how do you mitigate portfolio risk?

A: We have a pretty sophisticated, proprietary, internal risk management system that we built in 2000. We use that as well as the Barra system. We believe more on managing than controlling risk. This is because our clients pay us to take risks. However, we want to maximize the compensated risk and eliminate uncompensated risk. Hence, whenever we study our portfolio vis-à-vis our risk management system, we want our areas of greatest insights in the portfolio to be our biggest contributors to active risk.

Sometimes that can be from an area that we have avoided because the specific analyst has done a good job valuing securities in a space that might be really overpriced. We find that a big source of active risk in any portfolio can be both what we own and what we don't own, and we want our source of active risk to be basically the areas of greatest mispricing. And at different points of time that can be both underpriced and overpriced areas.

For example, in 2004 and 2005, Mike Nell, our computer hardware analyst, kept us out of semi conductors, which was a really overpriced area and hence one of the biggest contributors to active risk. Consequently, we were able to underweight an area that really was a big danger spot for the portfolio. Of course, today, there are some good opportunities in that space and so there, it isn't a permanent underweight. 

UBS U.S. Large Cap Value Equity Fund

Symbol	BNVAX
Website	www.ubs.com
Address	UBS Global Asset Management 51 West 52nd Street New York, NY 10019-6114
Tel. No.	800-647-1568
Inception	12/07/2001

PORTFOLIO	
Total Net Assets*	\$110.3
Avg Mkt Cap (\$ Weighted)*	\$93,200
Average Price/Earnings Ratio	16.77x
Average Price/Book Ratio	2.77x
Turnover Ratio	41%

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

RISK (AGAINST RUSSELL 1000 VALUE TR INDEX - 3 YRS)	
Alpha	0.20
Beta	0.82
R-Squared	0.87
Ann. Std Deviation	6.80
Sharpe Ratio	1.44

RETURNS VS. RUSSELL 1000 VALUE TR INDEX		
	BNVAX	Index
1 Year (Cum.)	5.70%	3.06%
3 Year (Ann.)	11.35%	10.86%
5 Year (Ann.)	13.82%	13.83%

RETURNS VS. S&P 500 DAILY REINV INDEX		
	BNVAX	Index
1 Year (Cum.)	5.70%	7.72%
3 Year (Ann.)	11.35%	10.09%
5 Year (Ann.)	13.82%	11.63%

FEES AND EXPENSES	
Max Sales Charge - Front	5.50%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	1.10%

PORTFOLIO MANAGER	
Thomas Digenan	01/01/2001
<i>*millions **for amount invested less than \$50,000</i>	
Data through: 11/30/2007	
Source: Company Documents; Lipper	

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