

Small Risks to Consistent Gains

The threat of recession looming over credit markets where even fixed income risk sectors faced the worst period in history, is a very tough scenario. Yet the managers of Vintage Limited Term Bond Fund, Jeffrey D. Lorenzen and Kevin W. Croft seem to have succeeded by following an active risk budgeting investment process that gave them a yield advantage versus the benchmark and a portfolio of high credit quality holdings.

Q: What are the core beliefs that guide your way of money management? How would you describe your investment philosophy?

A: The key aspects of our firm philosophy are the preservation of capital in difficult markets, the long-term view towards investing, and the risk-budgeting construction process. A separate layer of our philosophy refers to the specifics of the fixed income market.

We believe that capital preservation, which is very important in difficult markets, also allows for greater compounding when the markets are rising. The long-term view means that we filter out the short-term noise and we focus on long-term valuations and opportunities. Maintaining an active risk-budgeting process allows us to allocate portfolio risks to the opportunities poised for best performance.

Regarding the fixed-income market, we have a diversified, actively managed approach. The goal is to capture multiple sources of excess returns, which result in above-market performance. In other words, we take many small risks rather than few large ones, and our performance is driven by many different components, not by a single big holding.

The key result of that approach is a greater level of consistency over time. Instead of taking large duration or credit biases, we believe that balancing our risk across all the elements of the portfolio leads to consistent above-benchmark returns.

Q: How that philosophy translates into an investment strategy?

A: Our investment process is built around four main drivers of fixed income - duration or interest rate risks, yield curves, sector rotation, and security selection. About 60% of our performance comes from top-down issues like interest rate risks, yield curves, and top-down driven sector rotation, while 40% of the performance comes from bottom-up factors like security selection and sector rotation.

The sources of our returns vary from year to year, and our allocation depends on the market opportunities. Certain periods are top-down focused, while others depend more on the bottom-up approach. Overall, we have a flexible process that searches for the opportunities the market provides.

Regarding the interest rate risk, or duration, we have a very fundamental approach, driven by the market and the economy. We manage duration over a cycle, not on a day-to-day basis. Our sources of information are balanced among outside research providers, our own observations and experience and our interest rate and economic models.

For the yield curve, we look at short, intermediate and long maturities. This aspect is mainly driven by the rate cycle and the direction of interest rates. We anticipate the actions of the Fed and apply an appropriate strategy based on those actions. In some instances, we maintain a portfolio structure with more assets settled in the middle of

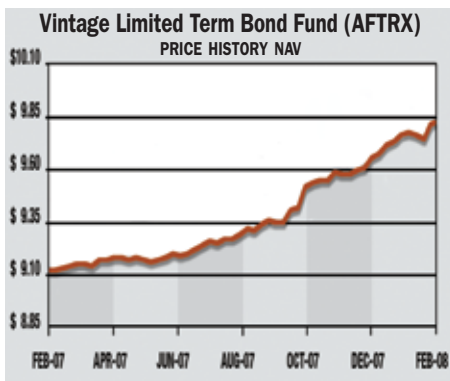


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Lorenzen earned a BBA from the University of Iowa, an MBA from Drake University and his CFA Charter in 1993.



KEVIN CROFT is the Fixed Income Group Manager at WB Capital and manages the day to day investment activities for the Vintage Limited Term and Vintage Bond Funds as well as a number of institutional investment portfolios. Croft has been in the investment profession since 1993 and with WB Capital since 2003.



the yield curve because those do well when rates are relatively stable. When the yield curve is changing very quickly, it is beneficial to put assets on the short end of the curve and a little bit further out.

In terms of sector rotation, we analyze the bond market in two different parts. While many people do tactical allocation in terms of what looks cheap, we also use strategic allocation. For tactical allocation, we compare the yield relationship among the sectors and have identified different performance drivers for each sector. For instance, mortgage-back securities do well when interest rate volatility falls. Hence we focus closely on interest rate volatility to help guide us in our sector allocation to mortgage type products.

For the strategic part, we have done historical analysis of the returns and the volatility, or risk, of the returns of each sector. We look for better risk-adjusted return opportunities, and we seek opportunities that are within our risk budgets. For example, on the short end of the yield curve, we tend to replace Treasuries with short corporate,

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agency, asset-backed, and mortgage products because they have good excess return profiles with relatively low volatility. They may underperform in the short term, but they are a good place to be over the long part of the cycle.

Regarding the security selection process, we use fundamental analysis. The goal is to search for extra income that is supported by the fundamentals, or for an appropriate amount of income for the incremental volatility that any security adds to the portfolio. On the mortgage or asset-backed side, we sustain very high credit quality. We prefer to buy fixed-rate securities and we do not buy derivatives such as total return swaps, CDO's or CLO's.

In general, we recognize income as the most important component of total return. Maintaining a high level of current income is crucial, especially in the shorter duration part of the portfolio. That belief influences our sector rotation, security selection, and yield curve work.

Q: What is your strategy for anticipating the Fed's actions? Would you compare the eras of Greenspan and Bernanke in terms of flexibility and predictability?

A: From my experience, Greenspan was a bit more clear and you could gauge what to expect, but I also think that it was easier for him to guide the market. Bernanke is in a situation where many investment managers and traders are well versed on the rate outlook and the expectations. Now the market is trying to run the schoolhouse and the teacher is trying to maintain control. Bernanke has his ideas, but the market is ahead from what we have learned from Greenspan. There is a greater communication challenge for Bernanke, not because he is Bernanke, but because he is following Greenspan and the market has become more difficult.

For the Limited Term Bond Fund, where the portfolio is limited to five years or less, the Fed's activity is much more important than long-term Treasury yields. We do keep an eye on long-term Treasury yields for the Vintage Bond Fund and for our long-term cli-

ents, but for this portfolio, the Fed has probably more implications to the total return.

Q: How do you research the corporate bond segment?

A: In the corporate bond segment, we look for sound companies in strong markets, with stable or improving fundamental outlooks. We have a couple of credit analysts who use technology very efficiently to cover a wide part of the fixed-income universe. We maintain coverage of approximately 200 corporate bond issuers and we evaluate and rank them on a fundamental basis.

We look at financial metrics such as, interest coverage, debt ratios, and free cash flow. We examine the earnings, revenues, margin growth, and the management track record. Their business strategy, acquisition activities, and quality of growth are also important.

Another factor is their sector and market. We may like a firm, but it is also important if we like the current dynamics of its sector. Sometimes we may select a premier issuer in a troubled sector, but it all comes down to the fundamentals of the issuer, their position and strength in the market, the management team, and its experience in managing mergers.

Some companies are relatively acquisitive, but some are also good at it. Often we would consider such a company for the portfolio after an acquisition. If it just did an acquisition, its debt will be higher, but we do not mind that if the management team has the experience of working the debt down and integrating the new company well.

Q: What are the key aspects of portfolio construction?

A: The portfolio construction process is tightly related to the risk management. After we have identified a number of opportunities, portfolio construction is about allocating the risk to the ideas with the highest return potential. We go through our sector weightings in terms of agencies, Treasuries, corporate bonds, and mortgages to establish our view, and that affects the security weightings. Individual holding size is influ-

enced by our investment conviction, the appropriate level of overall risk and risk relative to our benchmark.

We hold a diversified portfolio, where the number of securities varies between 50 and 125. Our exposure to any corporate bond is limited to 0.5% to 1% of the portfolio. When holding a corporate bond instead of a Treasury, the idea is to get additional income, but it should be an appropriate amount income for the incremental volatility. If a corporate bond runs into trouble, it could have a significant price decline, and we make sure the portfolio can still perform well, even if one or two securities are under pressure. However, the foremost goal of our decision process is to identify securities that will not experience problems.

For the mortgage securities, we maintain a larger position size, partially for trading execution. We are comfortable with agency bonds from a credit quality standpoint, so we may take larger positions. Overall, we are very cautious in the security selection process, and we have a risk management framework to minimize future problems.

Q: How do you navigate through the mortgage market in this difficult environment? How do you make sure you avoid the largest losses?

A: In the mortgage market, the focus for us is on fixed-rate bonds with high quality collateral. We get consistent cash flow, both principal and interest, and that provides safety and reinvestment opportunities for the portfolio.

Typically, we avoid the adjustable rate mortgages in all of our accounts. As the rates adjust the quality of the borrower's composition changes over time, as a rate change creates a different type of product for the borrower. We like the certainty that comes with fixed payments and we feel that is a way to mitigate the risk in the mortgage sector. The fixed payment products provide more analyzable positions and more definable cash flow.

Moreover, we don't just analyze the type of product; we also look at the details. We

get into the details of the collateral, its stratification, its location and regional economic dynamics. We look under the hood to see the characteristics of the borrower as well.


Q: Would you explain your risk control and risk-budgeting process?

A: Our goal is to invest in risk-managed opportunities, and we measure the portfolio risk through multiple forward-looking scenarios. The process involves both judgment and a quantitative approach. The quantitative aspect helps to show how the portfolio will perform and identifies hidden correlations between securities or sectors.

We maintain a tracking error that we feel is appropriate for the product, but we don't do that blindly. For example, in 2006 and 2007, we intentionally brought down the risk of the portfolio because, going forward, the number of opportunities was not as great. Overall, we are opportunistic, but we maintain a risk level that is appropriate for the specific environment.

Our risk management framework involves a number of constraints, such as the corporate issuer limit and sector limits. We also maintain a high average credit quality and a yield advantage. We are bond portfolio managers and we do not invest in CDOs; we don't take currency risks; and we don't participate in total return swaps.

For the risk management framework, we use an analytical platform. It helps to ensure that our relative risk contributions are aligned with our investment convictions. It provides a broad array of sector and security details that help both the portfolio construction process and performance attribution. We can examine our past performance and analyze the reasons behind this performance, and see what we could have done differently.

Because we know that we cannot be 100% right in all our decisions, we prefer to take many small risks, and we analyze if the risks we took paid off. Overall, the diversified and risk-managed approach tends to work in our favor. 

Vintage Limited Term Bond Fund

Symbol	AFTRX
Website	www.vintagefunds.com
Address	Vintage Mutual Funds 1415 28th Street Suite 200 West Des Moines, IA 50266
Tel. No.	800-438-6375
Inception	06/15/1995

PORTFOLIO

Total Net Assets*	\$28.4
Average Coupon Percent	5.18%
Average Duration (Years)	1.73
Effective Average Maturity	1.96
Maturity Method	F

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$10,000
Min Subsequent Investment	\$100
Min Initial IRA Investment	N/A

RISK (AGAINST LEHMAN US AGG TR IX - 3 YEARS)

Alpha	0.24
Beta	0.37
R-Squared	0.59
Ann. Std Deviation	1.33
Sharpe Ratio	0.55

RETURNS VS. LIPPER SHT INV GRD FD INDEX

	AFTRX	Index
1 Year (Cum.)	7.64%	5.14%
3 Year (Ann.)	4.83%	4.16%
5 Year (Ann.)	3.46%	3.17%

RETURNS VS. RUSSELL 3000 TR INDEX

	AFTRX	Index
1 Year (Cum.)	7.64%	7.30%
3 Year (Ann.)	4.83%	5.18%
5 Year (Ann.)	3.46%	4.50%

FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	0.75%

PORTFOLIO MANAGER

Jeffrey D. Lorenzen	1998
Kevin W. Croft	2003

*millions

Data through: 02/29/2008

Source: Company Documents; Lipper

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