

## Diversified for Long-Term Growth

*CSI Equity Fund is built on the premise that the investment process is more predictable over a longer period of time than over shorter periods of time. Fund manager Leland Faust seeks to achieve his investment objective of long-term growth of capital by investing in a diversified portfolio of well-established companies throughout the world and utilizing both value and growth oriented investment strategies in the security selection process.*

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

**A:** We employ a long-term approach to investing. We believe that the investment process is more predictable over a longer period of time than over shorter periods of time, so we focus on longer-term trends and longer-term activities.

Another principle that we would adhere to is diversification. We believe very much in the quality of the investments that we make. We are much more interested in the tried and true than in the new and exciting. We try to combine those things when we make investments and we try to avoid losses as much as we can.

**Q: When you look at the tried and true versus the new and exciting, how do you categorize them?**

**A:** What we consider tried and true are companies that have a long history of relatively stable earnings and sales growth. We think that such companies are more predictable as they have followed the same approach to their business for longer periods of time. They are not usually companies that have refocused their business several times. We are looking for companies that have been consistent in how they

have managed their balance sheet and their debt.

**Q: How exactly do you look at the predictability of earnings?**

**A:** We have no proprietary formula. We look at what the company's long trend history has been. We would typically look at a 10-year earnings pattern and see what it has been in an absolute sense, relative to the economy as a whole, and relative to the industry and sector. We see how the company has performed in its particular environment.

Another thing we look for is how the company has grown its top line revenues over time. Are they doing it through internal growth or through acquisitions or price adjustments? We think that if you understand that, you'll have a better chance of knowing what the future will be.

**Q: Where do you get ideas from and How is your research process organized?**

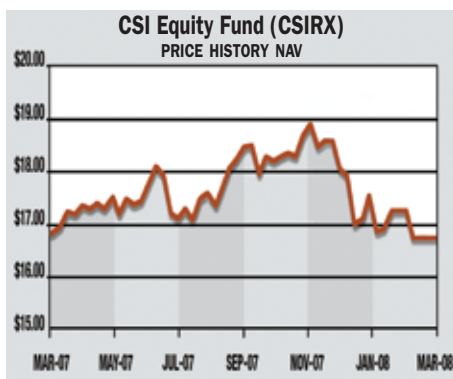
**A:** We don't have any one source for getting ideas. We constantly review the stocks in our investible universe. On the domestic side, most of the companies that we have are in the S&P 500 index.



**LELAND H. FAUST** has been Chairman of CSI Capital Management since 1978 and heads its Investment Committee where he serves as chief investment counsel for over \$1 billion in assets. He manages portfolios for high net-worth individuals, athletes, entertainers, foundations, family estates and pension plans. Faust is Senior Portfolio Manager for the publicly traded CSI Equity Fund, which has been recognized as a top performing equity fund by *The Wall Street Journal* and *USA Today*.

Faust was ranked 10th in *Barron's* "Top 100 Independent Financial Advisors" report, August 27, 2007. He was also named to *The Sporting News* "100 Most Powerful People in Sports" in 1994, one of only two investment advisers ever named to the annual list. He received a BA in Economics from the University of California, Berkeley, and a JD, cum laude, from Harvard Law School. He is an avid swimmer, and all American triathlete.

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We run computer screens to check for growth in earnings, in dividends and in sales. We read various journals and get ideas just from being part of the financial world.

We are not locked into any particular Wall Street investment style, so we are not looking just for growth or just for value but we invest across the spectrum. We don't have to worry about a classification of growth or value because we are not trying to fit into any style box. We certainly have investments that would be characterized as both growth and value.

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

**A:** Generally speaking, we have between 50 and 60 stocks in the fund. We feel that this number gives us enough diversification for safety, and yet we are not so diversified that if we make good selections they get completely averaged out. We believe that with diversification across sectors and industries and internationally, 50 to 60 stocks are enough for the downside protection that diversification provides.

**Q: What's your average historical turnover?**

**A:** Our average turnover for the last five to seven years has been in the range of 15% because we are looking for trends to play out over a longer time-

frame, and we do not look for short-term gains.

**Q: How do you go about portfolio construction? Could you explain your buy discipline?**

**A:** If we like a particular company and if we are deciding to invest, we have to identify the sector which the company is in and what is our exposure is to that sector. We certainly look at what our concentration is relative to the S&P 500 although we do not limit ourselves to the S&P 500 weights. We are willing to have relatively significant differences between the S&P and our concentrations, but we don't abandon major sectors even if we think that they are overpriced. We have never been completely out of a major sector.

For example, we have been concerned about the financial stocks for a long time and have been light on them relative to most of the large cap indexes for some time, but we didn't completely avoid the sector because that's not our approach. When we change our portfolios, we migrate from sector to sector rather than jumping from sector to sector. We use that approach to keep the balance. Sometimes this desire for sector balance leads us to a sell decision. If we think a sector is fully represented and we want to add a stock in that sector, then, obviously, we have to prune another stock from the same sector.

**Q: Could you give us a couple of examples to illustrate your sell discipline?**

**A:** I'll give you one example to illustrate some of the long-term characteristics that we are looking for. We bought Time, Inc. before it merged with Warner. At that juncture, some of the more common metrics such as sales

and earnings for Time, Inc. and for Warner were fairly close to the same size. But prior to the merger, Time, Inc. had on the order of \$1 billion of long-term debt. Post merger, I think that the combined company had approximately \$1.1 billion of debt. Twice the company and eleven times the debt. We sold our position in Time, Inc.

Basically, it turned out that our judgment on that situation was correct. The stock of Time Warner didn't perform well for a number of years, in part because of the debt load. As years passed the company intentionally paid off some of that debt because it recognized the burden. The company grew significantly and many years later we felt that Time Warner was a very viable, good company, so we then bought it. Later, they announced that they were going to be swallowed up by AOL. At that juncture AOL was probably trading at a multiple of well over 100 times earnings and Time Warner was trading at 20 times earnings or so. If you push the two companies together, it would have required something like 80 or 90 times earnings to support the stock price. We didn't think the market was going to support that and that is why we decided to sell out of Time Warner. Eventually, the stock fell approximately 75%.

**Q: Markets change every minute and are very volatile. How do you deal with the short-term volatility?**

**A:** Dealing with the short term volatility can be quite difficult when stock prices are moving against you. We deal with that by having no set policy for when we must sell a stock that we have purchased and that has declined in an absolute sense or has declined relative to the market as a whole. If this happens, we'll have to review what has caused the shorter term swing. If we think that

our judgment was wrong, we can and we will change our minds.

A few years ago, there was a relatively modest earnings disappointment for Emerson Electric. I think the stock fell almost 15% in a day, but we didn't think there was anything terribly unexpected. Whatever Wall Street's expectations were for that moment, the company failed to meet them, and consequently the stock fell. We didn't believe that the company had changed its policy, its course or its prospects at all, and so, we decided to stay with it.

There is a similar example I could give for Johnson & Johnson. They had a problem with a Puerto Rican manufacturing plant, and its stock fell precipitously over a relatively short period of time. We decided that the long-term prospects for Johnson & Johnson had not changed. This was a relatively small piece of the overall puzzle, and the market had overreacted. We decided it would be better for us to stay on the course. In those two cases, we didn't change our course because the things that attracted us to those two companies hadn't changed at the time the stock temporarily fell in price.

**Q: What kind of risks do you perceive? What do you do to mitigate risk?**

**A:** We try to contain company-related risks, market related risks, and industry related risks in different ways. For individual accounts, we manage the market risks by having significant fixed income allocations.


We manage market risks for equity portfolios primarily by being diversified. We think that diversification helps a lot to mitigate the market risks.

International diversification is another

way to control risk. Yes, the international large cap markets have been more correlated with the U.S. market and with each other than they were maybe 15 to 20 years ago, but they are still not completely correlated. If you look at those correlations over longer periods of time, you will discover that there have been significant differences.

We construct our portfolios to keep representations in the many industries, and we certainly do not make huge industry or sector bets. Over time that tends to keep things stable. If you make a sector bet and you turn out to be right, obviously your positions will look very good while that's working. But when it turns against you, then you have a bigger swing. We don't want that to happen, so we try to contain the industry risks by keeping representation in the major industries and migrate from one industry group to another as we see our overall opportunities. Certainly, the percentage of stocks that we have in technology today is not the same as it was five years ago and it's not the same as it was 10 years ago. The same is true for energy, for financials or for any of the other sectors. All these sectors have always been in our portfolios, and we are not making huge industry bets.

For individual companies, we manage risks by going with industry leaders with strong balance sheets. Obviously, you have to look at debt levels for the industry the company represents. What's a low debt level for a financial services company would be entirely different for a manufacturing company.

Basically, it's the combination of those things that we think has allowed us to control risk and, at the same time, identify the right growing companies and participate in their success. 

## CSI Equity Fund

Symbol	<b>CSIX</b>
Website	<a href="http://www.csicapital.com">www.csicapital.com</a>
Address	CSI Capital Management 600 California Street 18th Floor San Francisco, CA 94108
Tel. No.	415-354-3000
Inception	10/15/1997

### PORTFOLIO

Total Net Assets*	\$87.94
Avg Mkt Cap (\$ Weighted)*	N/A
Average Price/ Earnings Ratio	N/A
Average Price/Book Ratio	N/A
Turnover Ratio	9.90%

### INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$1,000
Min Subsequent Investment	\$50
Min Initial IRA Investment	N/A

### RISK (AGAINST S&P 500 DAILY REINV IX - 3 YEARS)

Alpha	N/A
Beta	N/A
R-Squared	N/A
Ann. Std Deviation	N/A
Sharpe Ratio	N/A

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

	CSIX	Index
1 Year (Cum.)	1.53%	-5.08%
3 Year (Ann.)	8.15%	5.85%
5 Year (Ann.)	11.90%	11.32%

### RETURNS VS. LIPPER LARGE-CAP CORE INDEX

	CSIX	Index
1 Year (Cum.)	1.53%	-4.32%
3 Year (Ann.)	8.15%	5.78%
5 Year (Ann.)	11.90%	10.04%

### FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	2.00%
Max Redemption Fee	0.00%
Total Expense Ratio	0.99%

### PORTFOLIO MANAGER

Leland H. Faust	1997
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\*millions

Data through: 03/31/2008

Source: Company Documents; Lipper

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Our interview covers investment philosophy and strategy, research process, portfolio construction and risk control for funds. Through an interview we uncover long-term strategies and processes that help to generate long-term returns.

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