

Successful Backyard Investing

If you look at a smaller list of stocks, you are more focused and it is easier to find out when opportunities arise. That is the premise behind the Bullfinch Greater Western New York Fund. As a native Western New Yorker, fund manager Chris Carosa uses a traditional value investment approach with a behavioral twist to identify companies across a broad range of industries and market capitalization that have a major presence in the Buffalo and Rochester areas.

Q: What is your investment philosophy?

A: The Bullfinch Western New York Series is a regional mutual fund that invests only in companies with a significant economic presence in Western New York State.

We employ a traditional value investment philosophy with a behavioral finance twist. When we do our initial screening of stocks, we are not looking at prices but we're looking for sound financial statements. We define value primarily by the strength of the balance sheet and the quality of income statements.

Once we get a candidate list of stocks, we start looking at historical price ratios and start getting more into the behavioral side of things - how the market is reacting to various company developments and how that might impact the short-term trading of a particular stock.

Q: How does this fundamental view help you to build your investment strategy?

A: It allows us to be consistent in our practice year after year. We're not chasing investment fads or stocks that are sought by momentum investors. We are looking at fundamentals of business and look for investment merits based on balance sheets.

Q: Could you define Western New York State?

A: When we started the fund with that name, we had to specify the counties within that state. So we had a list of the 14 Western counties and, interestingly, on a map it's virtually a straight line halfway between Rochester and Syracuse going down from Lake Ontario to the Pennsylvania border and everything west of that is considered Western New York State for this fund.

I also believe that if you just look at a smaller list of stocks, you are going to be more focused and it might be easier to find out when opportunities arise. We are all native Western New Yorkers and we thought there would be an opportunity for us to do very well with a small group of stocks.

Q: What makes investing in Western New York companies attractive?

A: These are stocks in our own backyard. We are constantly inundated by the local press with the news on these stocks and we're able to see superstar stocks before the rest of the industry sees it.

I can give you a good example - we started investing in Graham Corp. years ago. It was a good stable company in terms of the value prospects, really small, though. It wasn't noticed by Wall Street because a lot of the screens have minimum market cap values. And when the oil prices started to

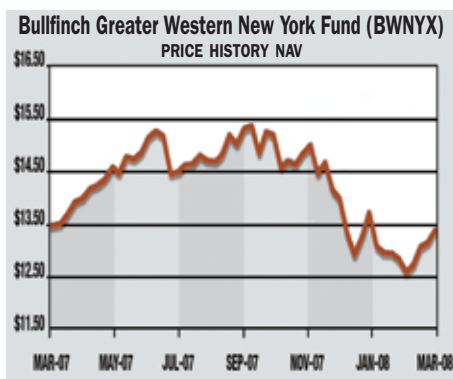


CHRISTOPHER CAROSA CTFA founded the Bullfinch Fund, Inc. in 1997 after spending nearly a decade and a half at one of the nation's top investment advisers. He has direct responsibility for day to day management of the Series' portfolios.

Carosa is a prolific writer and highly regarded speaker. He is an award winning academic researcher and has published one book and contributed to another.

Carosa earned his BS (Intensive) degree in Physics and Astronomy from Yale University and his MBA (finance and marketing concentration) from the William E. Simon School.

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rise, all the oil companies went up and the rest of the market started looking at other companies that would have an advantage due to the rising oil prices. They eventually came down to looking at companies like Graham and, when there are not a lot of companies with huge upside potential in a very popular area of investing, that puts a lot of demand on the stock. The stock price has shot up as the oil prices have risen and the company continues to grow with the growing market.

Q: How is your research process organized?

A: We have access to a database of thousands of stocks. As we are multi cap, we have to look at all the available stocks that we can purchase. Our first screen identifies companies that have a significant presence within the Western New York State. That brings our investible universe of 9,000 stocks down to 250, so it doesn't give us a lot of choices.

We will do screening on that database based on the company records. We are looking for very strong fundamentals such as very little debt, fairly significant working capital to long-term debt ratio. That screen will give us what we'll call our classic value stocks or candidate lists.

There are stocks that don't quite click on all cylinders but come really close. They could be a more defensive or income-oriented type of stocks, generally with a higher yield, but with a lesser return prospect. On the flip side, we have opportunistic stocks, which are riskier than their peers, but have greater return prospects.

Q: Could you give us a historical example to illustrate your investment process?

A: A company like Corning, for example, would not have passed the screen based on the debt levels. We looked at the company as we knew what was going on from the broader market behavioral perspective. We saw everybody dumping the stock because of fears of bankruptcy. Our own research was saying that the probability of bankruptcy was very low. The market knew Corning as a fiber optic company but we saw the company having a small market position in the flat panel display market. From a behavioral standpoint, the stock price got pushed down and we saw that as an opportunity which turned out to be a good investment when LCD TV and then HD TV became popular.

I will give you another example from a top-down macroeconomic perspective. In the years coming up to 2000 when technology stocks were taking off, earnings were growing tremendously. We sold off a lot of our technology stocks by the end of 1999 with the idea that a lot of the earnings push that we were seeing in 1998 and 1999 was caused by the year 2000 (Y2K) compliance concerns. Most companies were overbuying technology; and this meant that in the years following 1999 those replacement cycles would be more extended. So we were able to sell off all our technology companies that we owned prior to the crash in the technology markets in 2000.

Q: What is the industrial scenario in Western New York? Do you see any kind of leadership?

A: Traditionally, Western New York is viewed as the place for past industries as opposed to future industries. The most famous industries that we've had are the industries that have had the most problems. For example, Bethlehem Steel was a big employer in Buffalo and now it is no longer there. Kodak, a big employer in Rochester, is now off the Dow Jones Industrial Average and its stature has diminished among analysts.

In terms of the growth industries that we're seeing, the biggest story is the advent of Paychex. Their focus has been in smaller companies and the smaller companies tend to grow even in economic downturns. Or at least they don't suffer such big swings as larger companies do. That has protected Paychex on the down side and has allowed it to grow.

Q: What industries do you diversify across?

A: We are looking at a slice of almost everything. We have neither avoided nor concentrated in any industry. We are well diversified for a fund that only has 250 stocks to choose from, although there are certain industry segments that are totally not represented in Western New York.

Technically, the SEC says if you're a regional fund, no less than 80% of your portfolio has to be invested in the target region. So our board of directors decided that some portion of that 20% ought to be used to make sure that the portfolio is diversified across industries, but not all of it. In practice it has only been between 5% and 7%.

Q: Could you describe your buy/sell disciplines?

A: When we identify a target company, we don't look at the price until we're comfortable that the company is financially sound. Once we've concluded the company is financially sound, we need to make some sort of valuation determination on that company. Asset based valuation is often very difficult, especially for the smaller companies where there's not a lot of public information available. That's when the behavioral finance techniques become most valuable. We look at price to sales, price to earnings, price to book and various financial parameters that are essentially price ratios. Then we look at the historical trading range the stock has been in and what might have caused the different shifts in this range and where we might be along that cycle. From there we will determine a severe market low and a 5-year target sell price.

These are our two extreme points. Within those extremes, we come up with a buy price and a 2-year sell price. The 2-year sell price doesn't mean we'll automatically sell it after 2 years. Rather, it tells us where the stock price has to be after 2 years in order to get to the 5-year return we initially expected. If a stock does hit a 2-year sell price, say, within 9 months, we'll take another look at it. If we still have the same 5-year price on it, we might sell that stock thinking we can buy it back later and still meet our return target. Part of the buy/sell equation we've developed includes some sort of down-side risk assessment. That's why we would end up selling that stock if it's gone up faster than we anticipated for no reasons that we could determine.

If there's a significant downside risk in a stock, we compare that stock with other stocks and pick the one with less downside risk. Likewise, if we have two stocks with the same downside risk, we will invest in the stock that has a higher upside potential.

We use these historical behavioral pricing trends plus the current price to determine where a stock falls on our watch list. We've had to develop our software to monitor trends and we are very disciplined in what we do.

Continuing with the process, let's say we have now received new information on a stock. This leads us to re-determine the buy/sell prices of that stock. However, because we're relying on information that is basically quarterly as opposed to hourly, we're certain that any particular quarterly number is probably not going to change our long term analysis. There might be something fundamental that would change our thinking, but in the typical quarterly reporting you'd rarely see something change.

Q: What are your views on risk and how do you mitigate those risks?


A: The greatest risk is failing to meet

your goal. Ironically, this has nothing to do with relative performance, indices or SEC-mandated performance reporting periods. We are not looking at fund volatility as measured by standard deviation as risk. If your goal is 10%, you have two scenarios – one, where you miss your goal by 5%, so you only earn 5%; the second, you surpass your goal by 20% and you earn 30%. For most people, common sense says missing the goal holds the greater risk. Modern Portfolio Theory, however, by defining standard deviation as a risk, considers the 30% return as the greater risk because it exceeded the mean by a multiple of four times more than the 5% return did. Well, we reject that; we are more concerned about the downside risk and that is reflected in the way we buy and sell securities.

We are intuitively more aggressive because we are limited in the number of stocks we can choose from. There's always the concern this limitation may hinder the performance of the portfolio. Fortunately, that hasn't happened. In terms of traditional risk you would have expected us to have higher beta or volatility and thus fall down more than the market, but, in fact, in terms of that measurement we didn't. So, Beta is not really our measurement of risk, either. Our measurement is each individual purchase and whether it has got a downside risk we're comfortable with.

Q: Like most absolute return funds, do you have any returns target?

A: From the SEC standpoint, every mutual fund has to identify a benchmark index. Our benchmark index is the Value Line Geometric Index and that's the one that's most consistent with our original universe of stocks as a multi cap fund.

Individual stock purchases have their own return targets. The most aggressive target has us buying a stock only when we think that we can sell it at a double within 5 years. The most conservative target has us basically just beating inflation. 

Bullfinch Greater Western New York Fund

Symbol	BWNYX
Website	www.bullfinchfund.com
Address	Bullfinch Funds 1370 Pittsford-Mendon Road Mendon, NY 14506
Tel. No.	888-285-5346
Inception	12/30/1997

PORTFOLIO	
Total Net Assets*	\$0.7
Avg Mkt Cap (\$ Weighted)*	N/A
Average Price/ Earnings Ratio	N/A
Average Price/Book Ratio	N/A
Turnover Ratio	5%

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$2,500
Min Subsequent Investment	\$250
Min Initial IRA Investment	\$500

RISK (AGAINST S&P 500 DAILY REINV INDEX - 3 YEARS)	
Alpha	-0.08
Beta	1.04
R-Squared	0.64
Ann. Std Deviation	11.20
Sharpe Ratio	0.14

RETURNS VS. S&P 500 DAILY REINV IX INDEX		
	BWNYX	Index
1 Year (Cum.)	0.29%	-5.08%
3 Year (Ann.)	5.05%	5.85%
5 Year (Ann.)	12.30%	11.32%

RETURNS VS. RUSSELL 2000 GRO TR IX INDEX		
	BWNYX	Index
1 Year (Cum.)	0.29%	-8.94%
3 Year (Ann.)	5.05%	5.74%
5 Year (Ann.)	12.30%	14.24%

FEES AND EXPENSES	
Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	2.00%

PORTFOLIO MANAGER	
Chris Carosa	1997

*millions

Data through: 03/31/2008

Source: Company Documents; Lipper

Ticker staff searches for mutual funds for their consistency in performance and durability of investment style.

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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