

Understanding Market Drivers

Rock Canyon Top Flight Long-Short Fund is built on the premise that in any given investment environment there is a unique set of factors that cause investors to prefer one investment style over another. Fund manager Jonathan Ferrell is trying to identify style trends that will persist for some time and create a return stream that has the ability to outperform in any market environment and has a low level of correlation with the market itself and with other traditional strategies.

Q: What's your investment philosophy?

A: We believe that in any given investment environment there is a unique set of factors that cause investors to prefer one investment style over another. Our philosophy is to understand the unique factors in the current environment that lead to outperformance or underperformance and then to invest the portfolio in such a way that we can exploit that unique element in every environment.

Our goal is to find style trends that will persist for some time. The result of this philosophy has been a return profile with two advantages: the ability to outperform in any market environment and a low level of correlation with the market itself and with other traditional strategies.

Q: What kind of investment strategy does this philosophy translate into?

A: On a daily basis we measure the impact that specific characteristics of stocks have on performance. These include valuation metrics, growth metrics and expectation-related factors such as changes in earnings or revenue estimates and broker recommendations. Also included are descriptive characteristics of the stock such as its size, sector, repurchase policy or dividend policy.

All in all, there are more than 100 factors that we look at. We use the data to create a visual map which helps us understand which characteristics are driving performance and which factors are being punished in the current environment. Then we watch that map carefully and navigate the portfolio to best capitalize on changes in the style factor landscape.

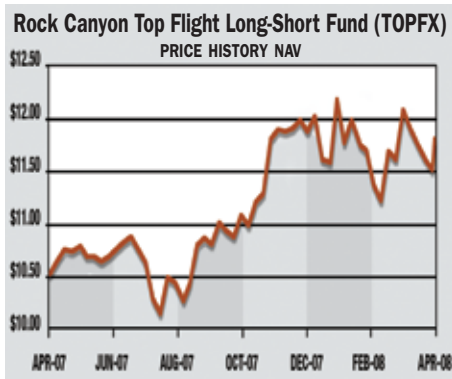
Q: Could you give us an example to illustrate how you put this strategy into practice?

A: Last year we noticed that the stocks exhibiting valuation characteristics that would normally be viewed as favorable were the stocks that were performing poorly early in the summer. As the year went on that style trend persisted. You saw deep value stocks, particularly in the financial sector, punished severely. In hindsight, you can see how the subprime crisis changed the way managers valued companies. For example, price-to-book might not have been a good valuation metric in July because many of the assets on the books of these deep-value financial companies were written down or written off by the beginning of this year. Although we had no crystal ball to tell us what would happen, we were able to use our quantitative methodology to recognize the unique nature of the en-



JONATHAN FERRELL is the manager of the Top Flight Long-Short Fund. He has managed the fund since its inception and is the President of Rock Canyon Advisory Group, the fund's advisor. Ferrell has been involved in the design and testing of quantitative investment models for twelve years, and is also Chief Investment Strategist for Lehi Partners LLC, an advisor to hedge funds.

Prior to establishing Rock Canyon Advisory Group, Ferrell was Director of Research at Paragon Capital Management. He holds a Bachelor of Arts degree in Near Eastern Studies and received his Master of Business Administration from the Brigham Young University Marriott School of Management. Ferrell has ten years of portfolio management experience.



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environment and capitalize on that in the portfolio.

Q: How do you go about stock selection?

A: We have a universe of about 3,000 stocks of all sizes that we consider to be liquid enough for the portfolio. We rank the entire universe by each one of the factors that we measure and plot the distribution of factor values for the universe. We concentrate on monitoring the behavior of stocks in the tails of the distribution because we believe the tails have leading characteristics compared to the rest of the distribution. An example of stocks in distribution tails might be very deep value stocks or the most “overvalued” stocks (by various valuation metrics), stocks that are seeing the most significant upward/downward revisions in analyst estimates, stocks that are seeing the greatest amount of price momentum to the positive and the negative side over various time horizons, stocks that have the highest growth expectations or have experienced the highest levels of revenue or earnings growth.

For each characteristic we look at our entire universe and especially at the tails of the distribution to see how that characteristic is affecting performance. Then we have a proprietary process of visually mapping the degree to which each factor is affecting the entire universe. We’ve found that there’s rarely a linear relationship between stock characteristics and stock performance, but we can often find nonlinear relationships, and these relationships are modeled and used in portfolio selection decisions on the long and the short side.

Q: Could you discuss some historical examples of your factor selection criteria on the long side and the short side?

A: At the beginning of 2008, on the long side we were specifically looking for larger stocks with negative short- and long-term price momentum, but with positive earnings estimate revisions for the next fiscal year. This combination of factors showed resilience in the face of

the significant market decline that got underway in January.

On the short side we were looking for positive short- and long-term price momentum, low broker ratings and high expected earnings growth. This describes the stocks which could be the most severely affected by an economic downturn.

Q: What makes your approach to money management unique?

A: Many managers often have in their portfolio stocks that are a favorite because of the story behind the company. The way that we manage the portfolio, we do not have story stocks. At any given time I will know what’s in the portfolio, but if someone asks me details about one of the companies I will be able to tell them the reason why that stock was included in the portfolio and under what conditions we will exit. I might not be able to tell them the “story” of the stock—for us that information is just a distraction.

Q: What happens when you hit your price target for a specific position? Can you give examples?

A: When a stock hits our price objective on the positive or the negative side, we exit the position and look for the next opportunity.

A good example here would be CF Industry Holdings, a chemical company. We opened the position because of high agreement in positive revisions among analysts; positive price momentum in the intermediate term; high earnings yield in the current fiscal year and current fiscal year sales estimates that were being revised up. CF was probably a recipient of the benefit of the falling dollar. It rallied almost 50% from its lows early this month and just recently hit our price target. We promptly exited the position.

We also covered a short position in Progressive Gaming (PGIC) recently. We entered the short because PGIC had positive short-term price momentum at the same time its earnings yield was

extremely low. Its expected EPS growth was high, and with negative analyst estimate revisions for the next fiscal year it fit the short position selection criteria we were using during the beginning of March. PGIC then promptly fell more than 25% from its February highs, and after it hit our downside target we came out of that position as well.

Q: How do you go about building your portfolio? What's the general number of holdings?

A: We typically hold between 50 and 100 stocks in the portfolio. We will use smaller position sizes for small stocks, and for mid-cap and large-cap stocks we typically take 2% positions on the short side and either 2% or 2.5% positions on the long side.

We don't rebalance because our holding period makes that impractical. We have specific exit criteria. We have an under-performance criterion and a price objective exit criterion. With every position that we take we hope that we'll reach our price objective and will exit the position and then reevaluate it at that time. Or if the stock stays in the portfolio for some time and does not perform as we expect then we take it out of the portfolio and replace it with another position that we feel will perform.

We don't constrain the portfolio on a top down basis to either a specific long/short allocation or to a specific sector allocation. We are bottom up in our portfolio construction. As we see long candidates and short candidates that meet our criteria and take positions, and as we exit the positions of the stocks that have met our exit criteria, both the long/short allocation and the sector allocation are shaped within the portfolio. Our long/short ratio will tend to move more toward the short side during rallies and more to the long side during declines. We came out of January primarily long in the portfolio. I think we reached at one point a net exposure in excess of 80% which was our peak. Net equity exposure has been declining as the market has recovered and currently now we're about 50% short, 46% long.


Q: What are your views on risk and how do you manage it?

A: We have the unique ability to not incorporate the sentiment about an individual company in a decision to buy or to sell. We also like to keep our position sizes small. We won't exceed 3% of the portfolio in any single issue and very rarely do we exceed 2.5%, so if there are unexpected announcements about a company that moves that position against the portfolio, the damage will be limited.

We do watch and maintain diversification. We don't deliberately concentrate in a specific industry. However, we allow the portfolio to select positions based on characteristics and it will from time to time create concentrated positions in a specific sector either on the long side or the short side. For instance, now we have a higher net short exposure to the energy sector than we typically do and at the same time we have about as high of a net long exposure to precious metals as we've had in the last year.

Q: Do you measure against a particular benchmark?

A: It's difficult to find a benchmark for this unique strategy. We have used the S&P 500 as our benchmark simply from the philosophical standpoint that we want the benchmark comparison to be simple and easily understood by investors. We do have the desire to provide returns that are market beating and we want to hold a positive beta over time. We don't try to be market neutral. We want to achieve returns in excess of market returns using both the long side and the short side.

Historically, we have done this while creating diversification opportunities because our correlation to the market is so low. As of the end of last month, we were beating the S&P 500 by nearly 3% per year, ranking second among all funds in our Morninstar category. Our beta, on the other hand is pretty low at 0.68 and our R-squared is really remarkable at 0.36. That kind of return in a non-correlated vehicle is difficult to find, and I think this is what sets us apart. 

Rock Canyon Top Flight Long-Short Fund

Symbol	TOPFX
Website	www.rockcanyonadvisors.com
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Tel. No.	800-869-1679
Inception	12/31/2002

PORTFOLIO

Total Net Assets*	\$16.6
Avg Mkt Cap (\$ Weighted) *	\$9,400
Average Price/Earnings Ratio	23.26x
Average Price/Book Ratio	4.2x
Turnover Ratio	2,119%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$5,000
Min Subsequent Investment	\$1,000
Min Initial IRA Investment	\$500

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

Alpha	6.45%
Beta	0.68
R-Squared	0.36
Ann. Std Deviation	1.96%
Sharpe Ratio	0.09

RETURNS VS. S&P 500 DAILY REINV INDEX

	TOPFX	Index
1 Year (Cum.)	9.90%	-4.68%
3 Year (Ann.)	6.40%	8.23%
5 Year (Ann.)	13.13%	10.62%

RETURNS VS. RUSSELL 2000 VALUE TR INDEX

	TOPFX	Index
1 Year (Cum.)	9.90%	-15.13%
3 Year (Ann.)	6.40%	7.29%
5 Year (Ann.)	13.13%	14.08%

FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee**	0.00%
Total Expense Ratio	3.86%

PORTFOLIO MANAGER

Jonathan Ferrell	2002
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*millions

Data through: 04/30/2008

Source: Company Documents; Lipper

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