

Rising with the Fallen Angels

In the definition of Gabriel Wisdom and Mike Moore, managers of the Fallen Angels Value Fund, a fallen angel is not a distressed company or a turnaround story. It is a high-quality company, temporarily on sale due to market inefficiencies. The crucial element of that strategy is getting the quality for the right price.

How would you describe your investment philosophy? What are your core beliefs in money management?

The cornerstone of our investment philosophy is to focus on high quality businesses that are temporarily on sale. The key factors we use in measuring the quality of a business are the company's ability to generate high rates of return on shareholders equity and total capital. Additionally, we look for businesses that have a history of growing sales and earnings. In terms of value, we try to make sure that we don't overpay for quality. We focus on finding companies that are trading at a discount to their intrinsic values. The basic principle is that the purchase price has to be right to make money on an investment, and the initial price often determines the rate of return. If we buy a great business at a discount price, and the company's revenue and the earnings continue to compound at attractive rates, then time is our ally.

After we have identified attractive businesses, we may have to wait for them to go on sale. The markets are volatile and even the most attractive sectors or securities occasionally go on sale. We

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typically don't look for distressed securities or turnaround stories. We look for fallen angels that should be rising, or for great companies whose share or bond price is at a substantial discount to what we feel it ought to be. The underlying business should be as strong as in the past but the companies have fallen out of favor with investors.

How do you translate that philosophy into an investment strategy and process?

Our investment process starts from a quantitative perspective. Although we may generate some ideas from scanning news the vast majority of our ideas results from our quantitative screening process. Screen criteria include consistency of sales and earnings growth, levels and consistency of return on equity and return on capital as well as other fundamental factors.

Once we have run the quantitative screens, it is a matter of finding the companies that should generate attractive rates of return at current price levels. We invest only in companies that we feel are trading at a discount to fair value. We look at value from a variety of angles including relative multiples of earnings, sales and growth. In addition, we like to put a three-year target on the position based on a reasonable estimate of future earnings growth. On this basis we generally look for 50% to 100% upside over that time frame.

We also use third-party valuation estimates to get a number of different points of view. We need to know the



GABRIEL WISDOM, is a Founder and Managing Director of American Money Management. He is also the President of AMM Funds, which includes two publicly traded no-load mutual funds. He has over 25 years experience in the securities industry, having served as a Senior Vice President of two NYSE member firms. Wisdom is on the advisory boards of the San Diego Treasurer/Tax Collector and the Harvard Business School Alumni Club.

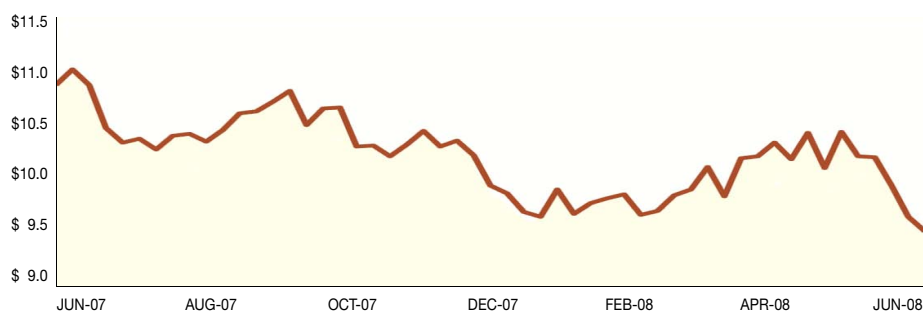
Wisdom has a Masters degree in Business Administration and is also a graduate of the Harvard Business School in Boston (OPM 26).



MICHAEL J. MOORE, CIO, is a co-manager of the Fallen Angels Value & Income Funds along with Gabriel Wisdom. Since joining American Money Management in 2001, Moore has worked to develop an active value investing strategy that seeks to invest in high quality businesses at attractive prices. As a partner of the firm, Moore provides research and analysis to support the investment process and chairs the Investment Committee. Additionally, he oversees trading for institutional and individual portfolios.

Performance - Price History N.A.V.

Fallen Angels Value Fund (FAVLX)



consensus view on intrinsic value because we know that the investment community will be looking at it. The view of the other money managers on the real value is very important, because the greater perceived value leads to greater participation by investors, and that will help us make money.

How does your strategy perform in the different environments? Is it an all-season approach?

The financial markets ebb and flow, and there are periods when everyone rides certain trends. If you miss those trends when they come along, you may have to wait quite a long time for the next mega trend.

The most difficult time for a fund like ours is in a raging bull market, where companies that meet our criteria for quality are not priced at attractive levels. When everyone identifies a trend as attractive, the securities often become overpriced, and our biggest challenge is to find the best value. In that kind of environment, we look for the highest quality at the most compelling value. Those are not necessarily the best performing stocks, because they do not become part of a bubble. However, they offer a good deal of safety and that is a big part of our investment approach.

We like bear markets because they represent a way to regulate all the imbalances that occur due to excesses. It is typically easier to find

great businesses on the cheap in these kinds of markets. The markets and the economies are cyclical, so we aim to profit from the inevitable downturns instead of panicking and selling.

Would you give us some historic examples of specific stock picks that illustrate the 'fallen angel' concept and how you benefit from it?

Accenture, the management and IT consulting firm, would be a good example of a fallen angel. Currently, the company is one of our larger holdings. It has made our screens for quality over the last few years, but we started to accumulate the stock in late 2007 or early 2008 because that's when it finally got down to a price that made sense to us. That is a perfect example of a company with consistently high returns on capital and shareholders equity.

Our fund can invest almost anywhere, including global ADRs, and another example would be Infosys Technologies. The India based software company's stock was beat up quite a bit last year due to the weakening dollar and concerns about global growth. Finally, it got down to a value price level in early 2008.

What would prompt a sell decision or signal potential problems?

We are always on the lookout for such issues, and our sell process comes into play when there are signs of a fundamental deterioration in the

business. Usually, we get warning signs either from lower revenue growth, weakening margins or other fundamental factors. We also view the trading activity, especially shorts, as a warning sign. In addition to fundamental factors we also consider the technical picture. If a stock that we like weakens dramatically it may be a sign that the mass of market participants may know something that we, as individuals, don't know.

Would you say that you look for deep value stories or for playing great companies against the market sentiment?

We take advantage of the consequences of negative investor sentiment, news events, or excessive volatility. What we really want to do is make the most of the inefficiencies in the market. The market may be efficient much of the time, but when it is inefficient, it is horribly inefficient because of human emotion.

A good example of that approach is our portfolio construction process. In general, we try to go where there is strength or where we see turning points. At the same time, however, we are willing to step into a down sector like the banks, starting with a small allocation. Although when things look as cheap as the banks do currently, they only get cheaper, but this allows us to at least begin accumulating names that we will probably want to own to a greater degree down the road. We treat those positions as 'tracking' positions.

How do you fine-tune your research and investment process? What changes have you made through the years?

We spend a lot of time looking at our mistakes. Everybody makes mistakes, but we do not want to repeat them twice. Of course, it is a lot cheaper to learn from the mistakes of other investors, but when you make mistakes yourself, it is important to go back and find out why.

We have found out that whenever we have stepped on one of the value traps, we were convinced to hang on

by an intelligent analyst, or a financial journalist who wrote something in Barron's or Forbes. We did that recently with Ford Motor. We don't own Ford in the fund, but we have a small position in some of our more aggressive accounts. It is one of the very few turnaround stories that we own and it was based on a compelling set of reasons. Now it is a \$4.50 stock and the analysts that raised their recommendations from sell or neutral to buy were all wrong.

We bought the whole branding idea because Ford is one of the most recognized brands in the world. We bought into the turnaround story that it was going to go green with its auto lineup. There was also some sell side support behind it.

But we have always done best by sticking with our discipline, which starts with quantitative screens and sticks to quality and value.

Do you believe in portfolio diversification and how many stocks do you hold in the fund?

We keep the portfolio relatively concentrated. Typically, we own 40 to 60 names, where the bottom 20 stocks represent smaller, tracking positions. For risk control purposes, we maintain diversification across most of the major market sectors. We tend to limit our position in any sector to 20% and we could go up to 25% only if we are extremely confident about the opportunities in that area.

We also follow the research on business and economic cycles, including data from the Commerce Department concerning the financial markets. That's how we managed to avoid the real estate debacle. The long-term data from the Commerce Department on the 18-year real estate cycle shows that nine rising years are followed by nine corrective years. Even at the top of the real estate bubble, the valuations looked good for home builders, mortgage lenders, and title insurance companies.


What helps you to distinguish a tsunami from just a current?

A declining or a rising trend will have momentum. That's very different from the day-to-day chop where the markets go nowhere. This is a difficult market environment for trend-followers and for investors with a long bias like us. We would rather wait in money market or in a short-term income instrument, than being invested in a choppy environment, where there is no direction. Often great companies will go nowhere for a number of years while their book value or shareholders' equity is doubling every three or four years.

This is the conundrum of many value investors. We don't want to wait that long because our shareholders are not that patient. Time is money, and if it takes 10 years to get a decent price move on General Electric, then your annualized rate of return is very modest.

What is your view on risk and how do you mitigate it?

The greatest risk that we perceive is permanent loss of capital, not volatility. We believe that the best risk management is to have a strong buy discipline. That's why business quality is key in our philosophy; it is our first line of defense. Portfolio diversification and the fact that we are willing to hold cash in the absence of enough good ideas also help to diminish the risk. We don't need to be fully invested at all times, and that strategy has worked well for us in difficult market environments.

I think that the greatest portfolio managers and investors of the last 100 years have certain characteristics in common. They pay little or no attention to the day-to-day price fluctuations and are always willing to buy at the right price. That is what we try to do every day. We find that if we pay more attention to the underlying business quality that gives us a margin of safety. If we buy at a substantial discount and the intrinsic value is rising, the book value is compounding, and the prospects for the business are good, then time can only be our ally, not our enemy. 

Fallen Angels Value Fund

Symbol	FAVLX
Website	www.amminvest.com
Address	American Money Management 14249 Rancho Santa Fe Farms Rd Rancho Santa Fe California 9206
Telephone	888-999-1395
Inception	11/10/2006

PORTFOLIO	
Total Net Assets*	\$19.1
Avg Mkt Cap (\$ Weighted) *	N/A
Average Price/Earnings Ratio	N/A
Average Price/Book Ratio	N/A
Turnover Ratio	96%

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$10,000
Min Subsequent Investment	\$1,000
Min Initial IRA Investment	\$4,000

RETURNS VS. S&P 500 DAILY REINV INDEX		
	FAVLX	Index
1 Year (Cum.)	-10.58%	-13.12%
3 Year (Ann.)	N/A	4.41%
5 Year (Ann.)	N/A	7.58%

FEES AND EXPENSES	
Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	1.88%

PORTFOLIO MANAGER	
Gabriel Wisdom	2006
Mike Moore	2006

* millions
Data through: 05/31/2008; Source: Company Documents; Lipper

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