

# Small Caps with Macro Views

*Huntington Situs Fund pursues long-term capital appreciation by investing in a strategic combination of U.S. and foreign companies whose situs, or geographical locations, give them a competitive advantage and the potential to outperform. Fund manager B. Randolph Bateman seeks to identify companies with situs advantages such as favorable political, social or economic conditions or population demographics.*

## What's your investment philosophy?

We take a top-down investment view. We feel that making decisions based on the macro economic analysis will have more of an impact on performance than anything else will. We try to understand how the factors taking place internationally, socially, and politically go into what is taking place in the broader picture.

We have a PhD economist on staff, Dr. George Mokrzan, who gives us a great understanding of what is taking place in our economy. We have our international specialist, Madelynn Matlock, who gives us a good understanding of what is taking place internationally. In addition, we have two external economists that we deal with. Dr. Art Laffer gives us a good picture on the politics and taxation issues and Mike Lewis gives us interpretation of short term economic data as it is coming across the daily news wires.

If we get a big picture, that will help us make decisions of a macro nature, which might be emphasizing value versus growth. It might be emphasizing cash versus equity. It gives us a determination of whether we want to be in certain of the 10 sectors where we will emphasize or deemphasize those sectors and then on down to the individual stock selection. One company over another might be more favorably positioned in the macro environment than we expect.

## Why do you believe that paying attention to the macro picture is important?

The statistics will bear out the fact that being in the right asset allocation is more significant than anything else you can do.



Dr. Benjamin King did a study a couple of decades ago looking at long-term histories of the market. His beliefs were that being in the right asset allocation, the right sectors represented about three-fourths of the overall satisfaction that an investor will have in the investment program. In addition, stock selection was approximately 11%.

We have about 90 investment professionals in our organization. We could do a lot of bottoms-up stock picking type of effort. However, in the environment that we see, we can rely upon our systems and our judgment to accomplish that very rapidly and that gives us a chance to spend our time on the big picture issues.

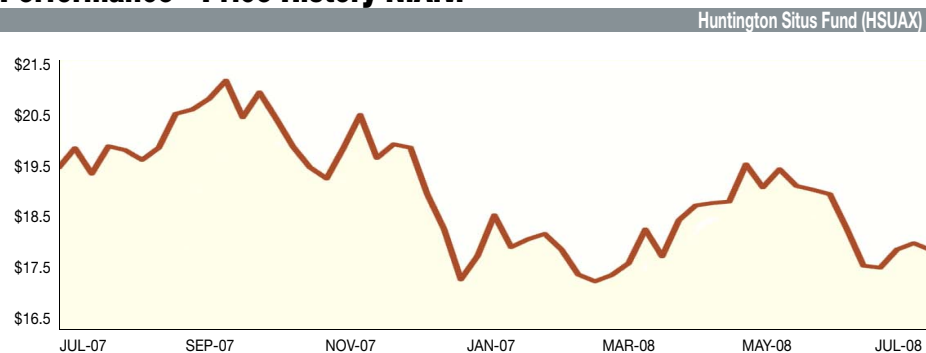
The past indicates understanding influences our investment behavior. When we saw the tax reduced on dividends to long-term holders, we noticed a significant increase in the value of those preferred stocks that had preference treatment on their dividends. We also had typically done things

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A graduate of North Carolina State University, Bateman has more than 30 years of experience in managing fiduciary accounts and he has served as an analyst and portfolio manager for four major banks. Earlier in his career, Bateman was founder and president of MPACT Securities Corporation, a Texas-based investment advisor. Randy obtained his Chartered Financial Analyst (CFA) designation in 1978 and has written numerous articles for financial publications.

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## Performance - Price History N.A.V.



with regard to whether assets were in tax-free type investments or taxable accounts. If an individual had a 401(k), we would invest it differently than we would if the same individual's assets were in a taxable type of account. We would not need to have that dividend shelter in the tax-free scenario.

A change in capital gains taxes will have an influence on us. In the 1970s, we had a period where capital gains taxes ratcheted up seven times moving from the low 20% to upwards of 48%. Consequently, we went through that decade with no secular uptrend in the marketplace. The Dow ended and began the decade at almost the exact level. Part of that was because of imposition of compensatory taxation.

### How do you use your core beliefs in developing an investment strategy?

The Huntington Situs Fund has the name "Situs" because the word 'situs' means location. As we were looking at ways that we could add incremental value to our potential shareholders, we started thinking about location. We added this unique element to the creation and the identification of investments to go into this fund: that those companies that had a competitive advantage over their counterparts. We examine companies that are in areas enjoying immigration into that particular area or that region. We research whether they might have a geographical advantage in access to their raw materials. We study those companies that are in states or areas that have more favorable taxation than their competitions.

### In small cap funds, managers would normally pay more attention to the company's ability to create new products than the macro environment.

We want to find those companies that have excellent management and product development capabilities. If you look at the history of small caps and review the efficient frontier theory, they certainly are more risky than their larger counterparts. Small companies consistently had a higher rate of return as well as more nimble capability to ship their production to meet the demands of an ever-changing marketplace.

We want to have exposure to all 10 of the major economic sectors. We do not think that we have the capability of spotting the technical advances in somebody like an Apple or the industrial applications applied or the healthcare capabilities. We want to supply our clients with a lower beta, a lower risk investment return than just strictly picking one stock at a tie and trying to find the next panacea or the next huge opportunity in the commercial marketplace.

### Give us some examples of stocks that you have identified and evaluated using your research process?

We have had a big run in the energy sector and I have been overweight in energy for a while. I am shifting out of the energy producers for the most part and moving more to the ancillary activities such as the contract drillers, seismographic companies, and oil field service companies. There are two reasons for this. First, I have been watching the stock prices of the producers of energy,

and they move lock step with the price of a barrel of oil. In addition, the producers are more likely to be under the scrutiny of the regulators as the windfall profits tax. We have the Democratic Party controlled U.S. Congress and in the U.S. administration as well. I think the energy area is a big target for windfall profit taxes whereas these ancillary services may not be.

One of my most recent purchases is a company called OYO Geoscope Corp. It is a very small cap company in the seismographic area. They benefit from continued activity whether that is going to be in Brazil, Russia, or in the United States. The producers of energy need these services in order to continue to seek out valuable fields.

We have created a proprietary company data sheet. We use it in all of our investment activities. With it, any of our portfolio managers can go into our system and pull this proprietary sheet for most U.S. companies. This is a sheet filled from five different sources ranging from Thompson to Value Line to Columbine with approximately 160 fields of data. I can quickly look at one-page on this particular company and compare it and the statistics that it outlines. It allows comparison of one company relative to another in three different categories. We try to get an understanding of the credit worthiness of the company, its solvency, and its ability to use its balance sheet to grow.

The second thing is quality. We have developed 10 statistics that allow us to understand the quality of the company and the decisions that management has made in the past. The third thing is the valuation in the marketplace.

Using the macro trend, we recognized that with the food and fuel inflation that is taking place in most countries, that the U.S. has an interesting advantage in terms of agricultural production. In that regard, we looked at ways that we could play the agricultural boom that is taking place there. The fertilizers and the seed companies had already had a big run.

I did not necessarily want to play that area because of the valuation. Looking at that same macro theme, we felt that there would be increased levels of farm income.

### How many stocks do you hold in your portfolios and what index is your benchmark?

The portfolio construction is very important. We want to have as consistent approach to our processes as possible utilizing our top-down investment calls. Part of Dr. George's work is to give us an economic overview and he has statistically created what we call the Vector Auto Regression model (VAR).

This model looks at where we are in the business cycle and the economic activity that is taking place. He uses a number of historical statistics and we come up with our recommendation of different industries that we feel will outperform or underperform the market and in which of the next eight quarters. It is a probability factor. He may have that auto parts, for the next quarter, will have a 30% probability of outperforming the market. The next quarter, it might be 50%. The third quarter, it might be 60%. In the fourth quarter, it might be 25%. To us an area that we probably would not want to have exposure to because only one quarter is there greater than a 50/50 probability of outperforming the market as a whole. As a result, we would deemphasize that area.

We roll all those industry sectors up into their major economic sector and we will use our subjective appraisal using our investment policy committee and make a decision of what sectors we will emphasize and which of the 10 sectors we will deemphasize. We keep that contained as well. We want to have exposure in all of our investment activities, all of our accounts, and all of the funds in each of the 10 sectors. We will have no less than a 60% exposure to the benchmark, and no greater than 140% exposure to the benchmark.

The benchmarks are different. My benchmark is the S&P small cap index.


Our mid-cap funds is the S&P 400. Our large cap is the S&P 500. The international fund is the MSCI EAFE index. We have an overweighting in technology of 110% now, so it is my job to be consistent with our philosophy and our investment efforts to have 110% of my portfolio would be 110% of the technology weighting of the S&P 600. That part of the portfolio construction is a function of our investment philosophy and it is something that we consistently require our portfolio people to adhere. For the Situs Fund, it is the S&P 600.

### What are your risk control techniques?

We use three techniques in our risk control. We write options and we have been aggressive in the use of options conservatively to protect our portfolio. I will write covered calls on positions that I own and I will write covered puts on positions that I might want to own at lower prices. We are always receiving a premium, which is some way a protection on the downside. Secondly, we keep this fund particularly widely diversified. Right now, I have about 110 domestic names and about 20 international names in the portfolio.

For example, take the Situs Fund, the top 10 names represent about 16% of the total portfolio, so it is not concentrated in any particular stock. The average price to earnings is about 19. The average price-to-book value is about 2.

The third way that we try to control risks is through international exposure. We can go up to 20% of the portfolio in international small cap names. Right now, we have about 9.5%. However, we do not buy ADRs that trade in the U.S. We buy companies that only trade on the foreign exchanges. It gives us a little bit different correlation to the U.S. markets as you would normally expect. Therefore, we only invest in companies that trade on their domestic exchange.

We have our valuation models that will employ in selling stock if we feel that they have become overvalued. In addition, we have our top-down sectors should they require us to make shifts as well to help control the risks. 

## Huntington Situs Fund

Symbol	<b>HSUAX</b>
Website	<a href="http://www.huntingtonfunds.com">www.huntingtonfunds.com</a>
Address	Huntington Asset Advisors Inc 41 South High Street Columbus, OH 43287
Telephone	800-253-0412
Inception	09/30/2002

PORTFOLIO	
Total Net Assets*	\$18.4
Avg Mkt Cap (\$ Weighted) *	\$3,300
Average Price/Earnings Ratio	19.3x
Average Price/Book Ratio	2.68x
Turnover Ratio	22%

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 YRS)	
Alpha	0.08
Beta	1.01
R-Squared	0.73
Ann. Std Deviation	11.73
Sharpe Ratio	0.06

RETURNS VS. S&P 600 DAILY REINV INDEX		
	HSUAX	Index
1 Year (Cum.)	-10.89%	-14.67%
3 Year (Ann.)	6.92%	4.10%
5 Year (Ann.)	14.52%	11.60%

RETURNS VS. LIPPER SMALL CAP CORE FUNDS INDEX		
	HSUAX	Index
1 Year (Cum.)	-10.89%	-16.99%
3 Year (Ann.)	6.92%	3.40%
5 Year (Ann.)	14.52%	10.20%

FEES AND EXPENSES	
Max Sales Charge - Front	5.75%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	1.59%

PORTFOLIO MANAGER	
B. Randolph Bateman	2002

\* millions  
Data through: 06/30/2008; Source: Company Documents; Lipper

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