

Separately Managed Relative Value

Traditional value disciplines may exclude entire areas of the investment world. That's why Todd Investment Advisors, Inc. (TIA) manage separate accounts with a discipline called Relative Value Equity, which requires diversification, uses a long-term outlook, and focuses on attractively valued stocks (using their Price to Intrinsic Value philosophy) with a catalyst to realize that value. The goal is to achieve predictable excess return with lower risk.

Q: How would you describe your investment philosophy?

A: We run separately managed accounts in a discipline called Relative Value Equity, which is a diversified, value-oriented management style. The discipline is based on the philosophy that a diversified portfolio of attractively valued stocks with catalysts, if held for the long term, should outperform the market with lower risk.

The key to our discipline is the price to intrinsic value method. Intrinsic value is the present value of future cash flows adjusted for the time you hold the stock and the risk of the investment. It's financial theory 101, and it is also very effective in finding attractive stocks. That's the base that we start from to invest in a diversified manner. This discipline allows us to see stocks as they are, not as Wall Street wants us to see them.

In general, our style offers a large-cap, high-quality, dividend-paying portfolio that's attractively valued and managed with a low-turnover discipline. We diversify across all of the S&P sectors and we haven't changed the philosophy or the process since 1986. When Bos Todd established the firm in 1967, he was a big believer in value investing and traditional measures like low price/book, low P/E, good dividend yield, etc. By the early 1980's, Bos and Bob

Bordogna, our current Chairman, found that traditional value disciplines exclude entire sectors of the investment landscape. They started the Relative Value Equity discipline in 1981 to establish diversified portfolios with an underlying valuation framework that allowed for comparing companies in different industries on an equal footing.

Bos Todd and Bob Bordogna have been managing money for more than 35 years each. Curt Scott, our President and CEO has been managing money since 1978 and he's been with the firm for 10 years. I (Jack White) have been with the firm since 2002, managing money since 1983. Each of us come from a different generation to bring our own experience and perspective.

Even though we have spirited discussions about individual stocks, we all agree on the basic concepts and drivers of the equity markets. We all believe that diversification keeps you in the market for the long term; good valuation limits the downside risk and provides opportunity on the upside; and the catalyst gives you the opportunity to outperform your peers over the course of a full market cycle.

Q: What type of investors should consider the Relative Value Equity strategy?

A: We believe that it's very important

Todd Inv Adv - Relative Value Equity

Fact Sheet

Website	www.toddinvestment.com
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Tel. No.	888-544-8633
Creation	1981

Equity Characteristics

Total Assets - RVE *	\$2,209
Total Assets - Total Firm *	\$3,879
Price/Intrinsic Value	0.74
Price/Earnings	15.7x
Price/Book	2.89x
Beta	0.89
Wtd. Median Market Cap *	\$47,192
Turnover Ratio	16%

Returns vs. Russell 1000 Value Index

	Todd RVE	Index
5-Yr (Gross) **	5.31%	6.89%
5-Yr (Net) **	4.69%	N/A
10-Yr (Gross) **	10.86%	10.85%
10-Yr (Net) **	10.27%	N/A

Returns vs. S&P 500 Index

	Todd RVE	Index
5-Yr (Gross) **	5.31%	2.49%
5-Yr (Net) **	4.69%	N/A
10-Yr (Gross) **	10.86%	8.32%
10-Yr (Net) **	10.27%	N/A

Professionals

John J. White	
Director of Research	2002
J.Christian Feduchak	
Director of MAPs	2001

* millions ** annualized

Data through: 6/30/06

Source: Todd Investment Advisors, Inc.



to know what your clients want. We're aiming for clients who want market participation with disciplined investment principles that seek to outperform over the long term with minimal volatility. The portfolio is appropriate as a cornerstone for high net worth individuals, pensions, endowments, and retirement plans where investors want predictable excess return, not hedge fund type of risk and return.

The biggest challenge for investors with portfolio management is when their implicit or explicit expectations aren't met. For example, in a slice of time with dramatic ups and downs, like the growth-oriented environment in January 1998 to March 2000, our clients and investors underperformed the S&P 500 and outperformed the Russell 1000 Value index. In the bear market of April 2000 to September 2002, we outperformed the S&P 500 and underperformed the Russell 1000 Value index.

Collectively, during both the growth and value phases, we outperformed both indexes with less risk and that's what our clients expect. We may give up a bit on the upside when the market's getting ahead of itself, but our goal is to protect the investors on the downside. Putting together the philosophy of mitigating risk, sector diversification, intrinsic value, valuations, and catalysts, helps us with our goal of outperforming over the full growth and value cycle.

Q: Despite the quality, consistency, and earnings predictability in names like Microsoft, GE, Home Depot, or Citigroup, sometimes the market may take much longer than anticipated to reward you. How do you convince your clients to be patient?

A: The market will experience value and growth cycles as well as large-cap and small-cap cycles on a very regular basis. They tend to last about five years and have certain characteristics. We try to emphasize that you need a full market cycle to beat the indexes. Disciplined patience is usually

rewarded in the market.

Large Caps have been out of favor for about five years, but does this mean they will be out of favor for the next five? Of course not, at some point they will come back and we maintain a healthy exposure in those names.

Right now the valuation is very compelling for the very large-cap names and it's only a question of when the cycle will turn. The small-cap cycle is over 5 years old and in our opinion, is likely to switch to large caps over the next 12 months. But it's the long-term nature of the investing process that helps to get people past the rough spots.

Q: How do you identify them? Would you describe your stock selection process?

A: We start with a universe that consists of 4,500 names and then we focus on the 1500 or so stocks with a market cap of more than \$1 billion. Realistically, most of our investments are in companies with over \$10 billion in market cap. We focus on the large-cap stocks because of the efficiency of information.

Next, we screen for quality and remove lower-quality stocks. This trims our list to approximately 1,300 candidates. Finally, we screen for stocks trading at a significant discount to the S&P 500 on a price/intrinsic value basis. This usually takes us to 300 names with the size, quality and valuation characteristics we like.

We'll extract 44 to 55 names out of that universe, where we see an active catalyst for the company to realize that value. We invest in those names in a diversified manner to maintain exposure in all the sectors.

Our price/intrinsic value model considers the price, the normal earnings, dividend yield, estimated annual growth rate, and the quality rating. We grow a companies earnings by what we consider to be a conservative growth rate for the next 10 years, and then discount the earnings

and dividends back to present values using a quality adjusted discount rate. We find this is a pretty good estimate of what an intrinsic or private market value for a stock would be.

Once we determine the intrinsic value, we compare it with the price in the marketplace and that's what gives us our buy or sell candidates. If we see a stock becoming too expensive, or a structural negative catalyst appearing, we'll take that stock out of the portfolio.

Q: Could you give us some examples that illustrate that sale process?

A: Sure, first let me say a copy of our buys and sells for the past year is available on request. Last year we owned Kerr-McGee because we thought that it had an excellent valuation and good growth opportunities in exploration and production. It turned out that Carl Icahn agreed when he acquired a position and convinced the company to take actions to realize that value. That drove the stock to the point where it became too expensive on our discipline forcing us to sell it and re-deploy those assets elsewhere where there was better value. We ended up putting the money into Marathon Oil and it worked out very well.

Such a discipline forces you to sell stocks that become expensive, even if they are still in favor in the marketplace. It forces you to look at the long-term values, not at the current sentiment.

Fannie Mae is another example where the structural catalyst we had liked was removed because of concerns about accounting. We had that name until the middle of 2003 and it had been a long-term holding for us. The price/intrinsic value was still attractive, but we couldn't be sure if the underlying assumptions still held true. That's a negative catalyst that forced us to sell the stock because we couldn't trust what we were seeing.

Q: That's very helpful for understanding your sell discipline. Would you also give us an example why you would buy specific stocks?

A: We bought Texas Instruments at \$23 because it was attractively valued on a price/intrinsic value basis with new products geared towards the digital consumer market. They had the Digital Light Processing chip (for large screen TVs) and were gaining share in the cell phone component market. With an attractive value and catalysts for growth, the company had been exceeding analysts' estimates as well. We added it to the portfolio because of that robust outlook.

We're playing the consumer electronics theme in a couple of names in our portfolio including Best Buy and Texas Instruments, so we've got the production and the distribution sides. We chose this theme because Americans like gadgets. The last time I checked, I didn't see a group of 30 people huddling around a 19" tube TV. People like to hang something the size of a doormat on the wall and watch it. Maybe that sounds simple, but people just like bigger TVs, better resolution, and more useful cell phones.

Overall, we're looking for a catalyst that will position the company to outperform expectations and peers over the next four to five years. The catalyst can be new products, restructuring, potential expansion, or potential new government regulation. The average turnover of the portfolio is between 20 and 25%, often less than that, so we're true to the discipline of a long-term holding period of these names.

Q: What are the milestones of your portfolio construction process?

A: We use the S&P 500 as our benchmark for sector weighting. We're allowed to have moderate sector variations but we cannot be entirely out of a major S&P sector or widely overweight in that sector. For smaller sectors, like materials that represent 3% of the S&P 500, we might have to 9% in the portfolio, but that would be very unlikely.

For the larger sectors, like financials that represent 20% of the S&P 500, we can vary plus or minus half the underlying

weight of the index, so we can be anywhere in the range of 10% to 30% of the index. Typically, we don't vary that much, but these are our official guidelines. This policy ensures that

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about

Jack White

Jack White, CFA, is Director of Research for TIA. The firm manages approximately \$4 billion. Jack is a native of Long Island, New York and received his B.S. in Finance from Boston College in 1982 and MBA from Baruch College in 1988.

Jack joined TIA in 2002, prior to that, Jack served as Director of Research for Wachovia Securities in Charlotte, N.C. He started his investment career in New York, working for Metropolitan Life as an equity analyst until 1987, then moved to Smith Barney where he was an equity strategist until 1994.

Jack is an active member of the Louisville Society of Financial Analysts, the CFA Institute, and a past president of the Charlotte Chapter of the National Association for Business Economics.

when one sector is aggressively moving up, we have to participate, but as stocks get expensive, we have to move into more attractively valued stocks within that sector and we'll probably go to the lower end of our weighting range.

Q: What is your view on risk control?

A: The risk control consists mainly of the diversification and the sell disciplines. We augment this through continuously reviewing names, especially names that have weakened significantly versus their competitors over the past couple of months. We have weekly research meetings to discuss names and ask ourselves if these stocks are going through normal pullbacks or if there is something structurally different. So the risk control involves constant monitoring, the sell discipline, and diversification. But it also includes the intangible experience of four people from four different generations and with different perspectives, discussing each of the securities in the portfolio.

Q: How important is customization for your individual clients and how do you handle it? Do you receive many requests to restrict specific sectors that individuals may already be exposed to?

A: Up to a point you can do customization, but you have to make sure that you still have the integrity of the portfolio to meet the expectations for the clients overall plan. If that's not possible, you won't meet the client's expectations, and everybody will be unhappy. So, we do customizations within reasonable limits. We hate turning away clients, but we hate even more damaging a relationship or not meeting the expectations for clients. You have to do the right thing for the client for the long term, or you won't be in the market for long.

A copy of the buys and sells of Todd Investment Advisors for the past year is available on request. █

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