

FRIC II US Growth Fund Manager Change

We have improved the manager mix of the FRIC II US Growth Fund by replacing aggressive manager, TCW, with another aggressive manager, Wells Capital Management (Wells).

Although both these managers have aggressive processes, they invest in very different ways. TCW has an extremely concentrated portfolio, at times investing around 20% of its portfolio in one stock and a longer term outlook. Wells, on the other hand, constructs a slightly more diversified portfolio. Wells also has a more opportunistic investment process, rapidly rotating between industry groups - turnover can be around 200%-300% per annum, compared to the 100%-150% peer group average.

However, with this change it was likely that the level of tracking error in the fund would fall, as we replaced a highly concentrated manager with significant stock specific risk, with a slightly more diversified manager. In order to maintain the appropriate level of risk in the fund, we have modified the weights of the other managers; lowering the allocation to Jacobs Levy - the manager with the most diversified portfolio.

Why Wells and why now?

We have known the team at Wells for some time, having previously researched it at its previous company - Strong Capital Management. The team's process has always been attractive. However, our research analysts don't just look at investment processes, they also look at how a company is structured; is the team and process well supported? At the end of 2004, the entire team was acquired by Wells - and we were quick to act! With the acquisition by Wells and with a new attractive compensation and incentive structure, we now

believe the team has the organisational stability it needs to succeed.

The longevity and cohesiveness of the team is one of its attractive features - it was even intact before its time at Strong and the key members originally worked together at Conesco Capital Management. This is a major benefit. Team members know how each other thinks and understand the strengths each member brings to the table.

Wells' investment process

Research

The team is led by Tom Pence and Eric Voss, two impressive portfolio managers. They run a bottom-up, qualitative process, leveraging their considerable experience. Wells' main focus is on idea generation and it allocates a great deal of time to this - particularly attractive is the concentration on proprietary research, rather than 'street' or market data - ie what other investors think about a stock. The team aims to 'surround' stocks with detailed research. What does this mean? Wells doesn't only analyse company fundamentals, its rigorous research process includes frequent contact with company management, competitors, suppliers and even customers. And its significant research resource, in the form of eight analysts, allows it to identify timely information that could affect a company's share price before it's released to the market.

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Portfolio construction

Interestingly, Wells constructs three portfolios, each with a different emphasis on earnings growth:

- Core holdings (40%-50% of the overall portfolio)
These stocks display consistent earnings growth and a high ROIC (return on invested capital) - how the company is growing shareholders' money. The stocks in this portfolio also have proven management and a record of high historical growth. Wells aims to hold stocks in this portfolio for around eighteen months.

- Structural change/evolving opportunities (30%-40%)
In this portfolio, Wells aims to hold stocks with a low ROIC which is turning into a high ROIC, ie turnaround situations where the company is beyond the event that resulted in low profitability. Wells aims to hold these stocks for six to twelve months.
- Valuation opportunities (10%-20%)
These are stocks with above average growth prospects, but are trading at low valuations. Wells looks for catalysts that will improve share prices over the short-term, normally holding these stocks for one to six months.

Process diversification

Wells

- Mid to large cap
- Industry rotator
- Concentrated portfolio
- Opportunistic process

The evolving opportunities and valuation opportunities portfolios give Wells a mid to large cap orientation. We believe the product will perform best in mid cap-driven markets, favouring cyclical companies and may underperform in markets favouring lower beta mega cap companies. The shorter-term nature of two of the three portfolios also makes Wells an industry rotator - it moves from one area of the market to another as opportunities present themselves. Wells is less scenario-dependent than most of the other managers in the fund.

Marsico

- 'Star' fund manager
- Thematic process
- Concentrated portfolio
- Opportunistic stock selection

Marsico's process revolves around one portfolio manager - Tom Marsico. Marsico is a thematic manager; it identifies themes such as economic, political and social trends and will buy the stocks it thinks will best benefit from them - no matter where they lie across the growth stock spectrum. As a thematic manager, Marsico also tends to have a longer-term outlook than many growth managers, but is also highly opportunistic in selecting stocks it believes offer the best risk/reward characteristics. While there is the possibility that Marsico's views may coincide at different points in time with the other managers, there is no reason to expect that Marsico's thematic process will be consistently correlated to them - it is also less structured than Jacobs Levy and less scenario-dependent than Turner.

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Turner

- Aggressive growth
- Price and earnings momentum driven
- Large cap bias
- Concentrated portfolio

Turner is an aggressive growth manager and holds a very concentrated portfolio. Turner looks for large cap stocks with high earnings and price momentum, meaning it performs well in cyclical growth markets. It only invests in large cap growth companies, so its return pattern is more scenario-dependent than either Wells or Marsico.

Jacobs Levy

- Quantitative process
- Diversified portfolio
- Finds opportunities across the market

Jacobs Levy is a quant manager with a highly sophisticated investment process; 70 different models incorporating a huge level of detail. Jacobs Levy runs a highly complex process and has a broader investable universe - therefore it finds opportunities across the entire market. As a quant manager it also incorporates value indicators, although it gives more emphasis to growth. This does, however, result in a more diversified portfolio than the other managers.

Jacobs Levy and Turner have more structured, predictable return patterns than either Wells or Marsico. Imagine these two managers are our 'anchors' in the fund; Levy as the lower-risk, diversified manager and Turner as the higher risk, albeit scenario-dependent, manager. These anchors give us the opportunity to include managers such as Wells and Marsico, who range around different areas of the market at different times

Manager weights

Manager	Previous Fund Weight	New Fund Weight
Jacobs Levy	40%	30%
TCW	15%	0%
Wells Capital	0%	25%
Turner	25%	30%
Marsico	20%	15%