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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Concentrated Value Portfolio Management

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SECTOR – GENERAL INVESTING

(AAB501) TWST: Would you please tell us about Logan Capital Management and your investment philosophy there?

Mr. Buchwald: Logan was founded in 1993. It now has about $1.2 billion in assets. That's divided among domestic equities, both growth and value, fixed income and international. We serve predominantly high net worth and institutional clients on a separate account basis. Marvin and I are responsible for the domestic value portfolios as well as the international portfolios.

Today we're going to talk primarily about the value portfolios. As I said, this firm was started as a growth shop back in 1993. Marvin and I joined in August 2000 and gave the firm some diversification in terms of what Logan can offer clients.

TWST: Focusing on the value side of your equity management, how have you been coping with the turmoil in the markets and the economic slowdown, and how this has impacted your investments?

Mr. Buchwald: As we'll discuss in more depth later in the interview, we manage concentrated value portfolios, and one of the attributes of our investment approach is that our portfolios hold up very well in down markets.

The last several quarters have provided ample evidence of that. More specifically, if you look back over the six quarters ended December 2008, you'll see that the Russell 1000 Value Index has declined in each of those quarters, which may be some kind of record. If you also look at Logan Value over that same period, you will see that it has outperformed in each of those quarters. Last year was obviously a very difficult year for the markets. Our benchmarks, which are the Russell 1000 Value and the Russell 200 Value indexes, were both down around 37%. However, our composite portfolio was down only about 22%. If you look back over our 13-year history you will also see that our portfolio has provided quite a bit of a protection over the long term as well. To a large extent, that downside protection has allowed us to meaningfully outperform our benchmarks over the last one, three, five and 10-year periods and since inception. By protecting the downside, we give investors above market returns over the long term and we do it with less risk as defined by either standard deviation or downside capture.

TWST: When you say concentrated, what is the range of holdings that you would have in your portfolio?

Mr. Kline: We generally hold 10 stocks and our fundamental belief is that investors should focus on their best ideas. We believe the more holdings you have, the more you dilute your portfolio's performance and the more your portfolio becomes like the market. Buffett said nobody has 40 great ideas, and that your 40th idea is not going to be as good as your 10th. We focus on 10 and, as Rich said, we've had over 13 years of above market performance with much lower risk than the market, which is counterintuitive because one of the objections we sometimes hear is that a portfolio of 10 stocks must be more risky than the market. Our thesis and our research shows that is not true, and we have 13 years of live performance to prove it.

TWST: Would you take us through the process and tell us what criteria you'd look for in these 10 to 11 top ideas?

Mr. Buchwald: Our process is straightforward. It's something that we developed back in the mid-1990s and we have been running the portfolio this way ever since with very little variation. Our first step is simply to take all stocks trading on US exchanges and screen for market cap. What we're looking to do is to screen for the top tier in terms of size. We identify the top 100 to 125 companies in terms of market cap, which today gives us a market cap minimum of about $20 billion, so that's our first cut off.

Then we apply a series of proprietary screens that test for things like excessive financial leverage, cash flow coverage of dividends, valuations and price stability, all of which are aimed at putting portfolios together that have low variability,

H I G H L I G H T S

Richard E. Buchwald and Marvin I. Kline manage concentrated value portfolios, which traditionally perform well in down markets. By protecting the downside, they provide investors with above market returns over the long term and they do it with less risk as defined by either standard deviation or downside capture. They generally hold 10 stocks because they believe investors should focus on their best ideas and the more holdings you have the more you dilute your portfolio performance and the more your portfolio becomes like the market. They look for financially strong companies that have relatively high dividend yields. They rank those stocks in order of dividend yield and take the 10 highest, subject to some sector constraints so that they are not too concentrated in any one sector. Currently, they have a 30% limit in energy, consumer staples and financials, and then 10% to 20% limits in all the other sectors.

Companies include; DuPont (DD); Altria Group (MO); Philip Morris International (PM); Verizon Communications (VZ); Kimberly-Clark (KMB).

are financially large and strong companies that can withstand periods of financial stress like the one we're living in today and can come through the other side in relatively clean shape. We don't want to have companies failing on us, so most of our tests are Graham and Dodd-like in nature and try to give us some margin of safety in terms of what we're paying for a stock and the comfort that these companies will be able to survive difficult periods in pretty good shape. That speaks to my first point about why our returns have held up relatively well in down markets.

Buchwald: Verizon Wireless recently acquired Alltel and they are now the largest wireless company in the country and their "triple play" with FiOS, Internet and phone is a very effective marketing tool. In a difficult economic period and relative to the rest of the world, their business looks pretty good. Their dividend yield is about 6%, which looks attractive compared to Treasuries' yields of around 2%.

1-Year Daily Chart of Altria

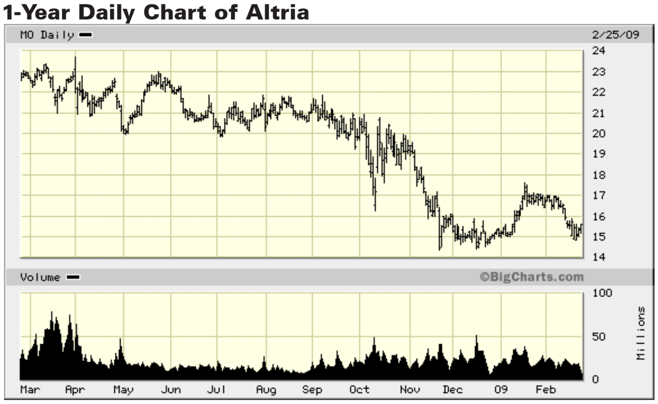

Chart provided by www.BigCharts.com

Once we go through those screens, we're left with 40 to 50 stocks that have passed muster and are all large, financially strong companies that have relatively high dividend yields. We rank those stocks in order of dividend yield and take the 10 highest subject to some sector constraints so that we're not too concentrated in any one sector. We've got a 30% limit in energy, consumer staples and financials, and then 10% to 20% limits in all the other sectors.

That gives us a portfolio of 10 stocks that we keep for six-month periods. We rebalance semi-annually at mid-year and at year-end, which is a function of research we did originally back in the mid-1990s and have updated periodically. Our research showed that if we rebalanced more often, we would simply be turning the portfolio more without getting additional returns. If we rebalanced less often, we found our returns would go down. Six months was the optimal rebalancing period.

Mr. Kline: What I'd like to add, in terms of the process and our philosophy, is that you can tell it's very quantitative and we believe one of the strengths of the process is that by being quantitative, we take emotions out of the decision process. One of the hardest things for a value manager to do is to buy stocks when all the news is negative and our process often forces us to buy stocks that are very unpopular, where the news and research reports are telling us it's not a good time to buy.

TWST: What changes have you made in your portfolio over the last year or half year?

Mr. Kline: In December we sold **GE** (GE) at around $16 and it's now around $11 per share. We sold it because we were very concerned about the safety of the dividend, even though management was very forcefully saying that the dividend was safe for 2009. Our analysis of the numbers led us to conclude that there wasn't much of a margin of safety as far as the dividend's sustainability, even though the company's CEO was saying that there was no way they were going to cut the dividend.

Interestingly, they have subsequently cut the dividend. That shows you that you can't always believe what management says. We had more confidence and trust in the numbers than what management said. Also, we saw this movie several times last year where a company said they weren't going to cut the dividend and three months later they did. In any event, we sold **GE** and we bought **DuPont (**DD) in the mid-$20s. We had sold **DuPont** in June 2008 in the mid-$40s. That was a good trade in that we were then able to buy it back in the mid-$20s six months later, and so far this year, **DuPont** is doing much better than **GE**.

TWST: What are some of your core positions that you have held for the longest time?

Mr. Buchwald: The stock that we've held onto the longest is one we've held since our inception in December 1995 — **Altria** (MO), the old Philip Morris, which has gone through several permutations over the years. It was split up last year between the domestic tobacco company, which is now **Altria**, and the international tobacco company, which is **Philip Morris International** (PM). I guess it's a pretty good example of what we do here. We've owned it for 13 years and I would say it's probably been out of favor for at least 12.5 years. There were times when it was clearly on its back in terms of sentiment when there were court cases that were hanging over the company. We looked through all that and our analysis was they would survive because most of those cases would be resolved in their favor. We believed the legal liability was not something that was going to ultimately bankrupt them. On the numbers basis, they passed all our screens, so we stuck to our discipline, kept it in the portfolio, added to it at times, and at times trimmed it back a little bit. That process has made our investors a lot of money over the years.

Mr. Kline: As a side note, **Altria/Philip Morris** has been one of the top performing stocks in the S&P 500 over the last 13 years and over the last 50 years as well.

Mr. Buchwald: As I said, one of the major ingredients of our process is that while we buy each position at approximately 10%, we will either trim it back or add to it over time, depending on what it's done in between rebalancing dates. If the stock has gone down and it still passes our screens and qualifies to remain in the portfolio, we will add to it when we rebalance. So if it becomes 8% of the portfolio because of the stock price moving down, we will add to it so it becomes 10% again. If it rises during a period to say 12%, we will cut it back to 10%. That discipline is very important in the process because it keeps us from falling in love with a particular stock, and we don't get scared to own them as they decline in value. As value managers, the proper thing to do when there is a stock that you own, but the price has declined is to buy more of it, not to sell it. That's the discipline that's employed here.

Kline: We generally hold 10 stocks and our fundamental belief is that investors should focus on their best ideas. We believe the more holdings you have, the more you dilute your portfolio's performance and the more your portfolio becomes like the market. Buffett said nobody has 40 great ideas, and that your 40th idea is not going to be as good as your 10th. We focus on 10 and we've had over 13 years of above market performance with much lower risk than the market.

TWST: Are there any other stocks that you can tell us about?

Mr. Kline: Together with **Altria**, we also own **Philip Morris International**. Combining them together, we have a 10% position in tobacco. In terms of weights, **Altria** is 3% and **Philip Morris International** is 7%.

1-Year Daily Chart of Verizon Communications

Chart provided by www.BigCharts.com

Mr. Buchwald: In rocky times like these, we appreciate what are really defensive stocks, and one that falls under that category is **Verizon** (VZ). People still think of it as the local telephone company with landlines that people are terminating, but as we see it, that business is only about 15% of its total revenues. The company has changed dramatically over the last 10 years. Its wireless business, its data business and its new FiOS TV business are all doing well. In a period where the economy is struggling they're not unaffected, but **Verizon** is holding up better than most.

Verizon Wireless recently acquired Alltel and they are now the largest wireless company in the country and their "triple play" with FiOS, Internet and phone is a very effective marketing tool. In a difficult economic period and relative to the rest of the world, their business looks pretty good. Their dividend yield is about 6%, which looks attractive compared to Treasuries' yields of around 2%. I would add that the dividend has been growing in recent years. That's the kind of stock that fits the bill. In a rip roaring market you are probably not going to have a rip roaring return with **Verizon**, but you'd be more than happy to own it in difficult markets where it holds up relatively well.

terms of stock prices to match the return of the market.

TWST: Do you have consumer staples as part of your portfolio other than Altria?

Mr. Kline: Yes, we own **Kimberly-Clark** (KMB). **Kimberly-Clark** is a household personal products company with a lot of terrific brands such has Kleenex, Huggies, Pull-Ups and Kotex. They've grown the dividend at an 11% rate over the past five years. Kleenex and Huggies are products where demand is not going to go down dramatically, though there will be some trading down to generic brands when the economy isn't doing well. The economy will be somewhat of a negative for their business this year. Also, 30% of their sales are outside the US and the current strength of the dollar is going to hurt earnings somewhat.

Buchwald: We've owned Altria for 13 years and it's probably been out of favor for at least 12.5 years. There were times when it was clearly on its back in terms of sentiment when there were court cases that were hanging over the company. We looked through all that and our analysis was they would survive because most of those cases would be resolved in their favor.

1-Year Daily Chart of Kimberly-Clark

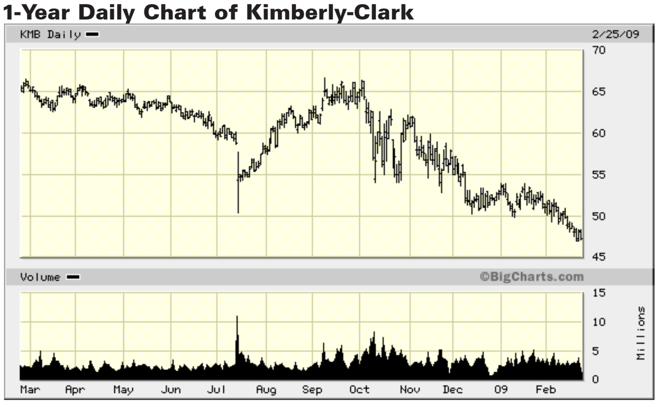

Chart provided by www.BigCharts.com

Mr. Kline: One other thing, just to tag on to what Rich said, is that **Verizon** has a yield of 6%. We think that in terms of total returns in a lower return environment, dividend yields are going to play a bigger part in determining total return over time. If the long-term return of the market is going to be 9% or 10% percent per year, we're getting about 60% of that through dividend yields and we only need about 4% or 5% appreciation in

Also, they've been hit with increased costs of raw materials for their products over the last two years. Energy and pulp prices have hurt margins, but those should be coming down this year. Consequently, they don't have to raise prices to maintain profit margins.

TWST: Do you do work on the sectors and pick leaders in that particular industry? Do you do any type of macro work or is it purely bottom up selection of the companies?

Mr. Buchwald: Ours is really a bottom-up approach. As you suggest, it is really a matter of which companies fit our criteria of strong, financially stable companies with high dividend yields that have the least downside, which is central to our investment philosophy. Eventually, with companies like those, there is some catalyst that will allow the value to surface. That's how we get our return over time — we bide our time, collect our dividends and wait for good things to happen.

TWST: Tell us about the risk management techniques that you incorporate within your process, at the portfolio level and the individual security level.

Mr. Kline: We reduce risk by focusing on mega-cap stocks. We find that, based on our investment experience and the history of the stock market, very large companies with strong balance sheets are generally too big to fail. You can take a lot of risk out of a portfolio by focusing on the strongest companies. That is the number one way that we reduce portfolio risk. In addition, by eliminating stocks with high debt levels, we avoid situations like Enron. We also eliminate companies where we don't understand or don't trust the accounting. Over the last two years, even though some of the financials would have met our criteria in terms of dividend yield and payout ratios, we felt very uneasy about their financial statements. As a result, we didn't buy **Washington Mutual**, which as you know went bankrupt and we didn't own **Fannie Mae** (FNM) and **Freddie Mac** (FRE), which are now each selling below a dollar. We've been able to avoid a lot of potholes by focusing on the fundamentals of very strong companies. The fact is, the history of our portfolios shows that we have very good risk controls.

Kline: Verizon has a yield of 6%. We think that in terms of total returns in a lower return environment, dividend yields are going to play a bigger part in determining total return over time. If the long-term return of the market is going to be 9% or 10% percent per year, we're getting about 60% of that through dividend yields and we only need about 4% or 5% appreciation in terms of stock prices to match the return of the market.

1-Year Daily Chart of DuPont

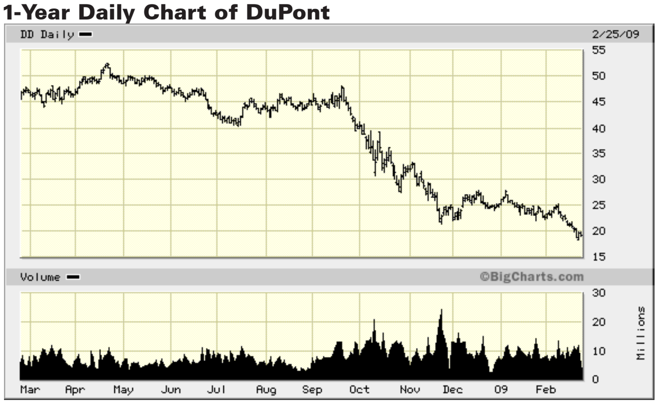

Chart provided by www.BigCharts.com

TWST: What do you think differentiates your approach of concentrated value to that of other firms with similar style?

Mr. Kline: We don't know anybody else who concentrates in as few stocks as we do and has done it for as many years as we have, so I would say the number one difference is that we have a low number stocks and that we have low turnover.

TWST: What about the depth or quality of your research?

Mr. Buchwald: With just 10 stocks in the portfolio, we know the companies well. Obviously with 10 stocks you can spend a lot of time on them and know them better than you can know 40 or 50 stocks, which I think is one of the advantages of concentration. As Marvin said, over the years there has been low turnover in the portfolio, about 30% per year, including trims and additions to existing positions. We become very knowledgeable about the stocks in our universe and we have a high degree of confidence that we understand what's going on within those companies and that helps us to avoid problems, the potholes that Marvin talked about, all of which accrues to our clients' benefit.

TWST: Looking ahead into this year, what is your outlook for your type of investing and are there challenges ahead that you foresee?

Mr. Buchwald: One of the things we often say is we're not very good at predicting the economy. Obviously, the economy is not in great shape right now. In this kind of environment I think investors just want to feel some level of comfort, that they can get through the period in some kind of reasonable shape. We've obviously shown that over time we can provide that defense — not every day or every month or every quarter, but over time. Especially in this kind of environment, I think our portfolio makes a lot of sense. That's not to say investors shouldn't have diversified portfolios because we don't know what's going to happen tomorrow and things could turn around quickly and the market could take off. I'm not betting on it, but it might happen, we don't know. We would say that there should probably be a mix between defense and offense.

Here at Logan, we're set up for that quite well. Our growth and our value products are often put together in portfolios for our clients to achieve that balance. If and when the markets do turn, our clients are prepared to participate. If the markets remain sloppy for a period of time, at least we will have defense helping part of the portfolio.

Mr. Kline: I think the current outlook, at least in terms of the economy, etc., is probably the murkiest it's been in our careers, and I think other investment professionals and economists would say the same thing. In addition, there is the uncertainty regarding what the government is going to do which will have a big impact on the economy and on a number of our stocks, and none of that can be predicted.

TWST: What advice would you give to investors at this time about entering the market and why is concentrated portfolio management better at this time than a widely diversified portfolio?

Mr. Buchwald: Let me answer that in two parts. Our basic advice is to maintain your discipline so that if you have an equity allocation of 60% or 70% that you maintain that. If the market is down quite a bit as it has been over the last year, begin to get the equity percentage back up. Clearly, almost by definition, it's a better time to invest now than it was six months ago when the market was substantially higher. That's what asset allocation is all about, sticking to a plan and over time taking advantage of temporary dislocations in one or more asset classes.

In terms of concentration, that per se is not good or bad. If it's done well, and we think we do it well here, then it certainly is good. We have a product that has low downside capture, low beta, with above market returns and below market risks. That seems like a good combination to me whether it's a difficult market or not.

TWST: Is there anything that you'd like to add?

Mr. Buchwald: There is one other thing that I would add, and it's something that we focus on here. Among virtually all the value managers that we look at, our product has about the lowest correlation we've seen to large cap growth managers. What you want to do when you are forming portfolios is to get managers whose returns are not highly correlated, otherwise you are not really getting the maximum benefit of diversification. Our portfolio's correlation with most large cap growth managers is about as low as you will see. That's why one of the things we do here at Logan for our clients is to combine both our growth and value portfolios together. So you get a market-like portfolio with higher than market returns and lower than market risks.

Mr. Kline: Consultants tend to use our concentrated value portfolio to reduce the risk and the volatility of an overall portfolio when putting it together with other styles because our value product has both less downside risk and lower correlation to other styles such as growth compared to other value managers. When putting the blocks together, I think our style fits well with other blocks in terms of reducing the overall risk for a portfolio.

TWST: Thank you. (PS)

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