
AFAM Philosophy and Process Review



General Information

Al Frank Asset Management, (AFAM) Inc. is an independent, registered investment advisor located in Aliso Viejo, California. The firm is registered with the SEC and notice filed in the state of California and various other states.

History Our firm was founded by Al Frank (1930-2002) in 1977. John Buckingham, Chief Portfolio Manager since 1990, and an accompanying investment team now carry forward The Al Frank Way, exercising diligence and prudence in applying our value-based philosophy to help meet the investment goals and objectives of individuals and institutions through the management of separately managed accounts and two proprietary mutual funds. The firm also serves as the editor of *The Prudent Speculator*, which has been the #1 ranked, not adjusted for risk, investment newsletter for the past 15, 20, 25 and 30 years according to The *Hulbert Financial Digest* (as of 12.31.10)

For the past 34 years, AFAM has stayed true to a commitment to buying undervalued securities for their long-term appreciation potential. That legacy, distilled into our long-term performance records, spans both good and bad markets over which the firm has flourished. We believe our longevity and record give us credibility to request of clients the patience required to potentially find long-term success in equity investing. That credibility creates trust with clients such that when the market tide turns against us, as it inevitably does, we are allowed to see our clients through to more prosperous times.

Investment products We manage private accounts as well as two proprietary mutual funds.

Managed Account Strategies

Select Value

Select Dividend Value

Investment Philosophy

Unwavering discipline is a rare quality among asset management firms. But at AFAM, we continue to adhere to the same strategy upon which the firm was founded decades ago: we seek to buy diversified portfolios of undervalued stocks for their long-term appreciation potential.

Perhaps nothing sets us apart more than our investment philosophy. We don't limit ourselves to the constraints of the nine style boxes, and so we are free to go wherever we believe the best stock values can be found. After screening for and crunching numbers to unearth and analyze these bargains, we construct our portfolios with broad sector and holdings diversification across the capitalization spectrum with an intent to improve our chances of owning those rare stocks that everyone wishes they'd noticed earlier.

This approach to selection and diversification gives us confidence that the true value of our investments should come to fruition in the fullness of time, so patience comes easily. And patience in turn enables us to have lower turnover of our holdings, which helps minimize our trading costs.

Broadly speaking, AFAM adheres to a multi-cap value (or all-cap value) style category. We utilize a go anywhere approach focused on uncovering bargain-priced stocks independent of market capitalization, seeking broad sector, industry and holdings diversification. Specifically, we seek long-term growth of capital through out-of-favor stocks that are trading for low multiples of earnings, sales, enterprise value-to-EBITDA and/or book value. We believe that growth is a component of value, and thus we strive to find inexpensive stocks in industries with above-average growth prospects.

[Investment style](#)

Investment Strategies

We maintain two multi-cap value strategies: Select Value and Select Dividend Value.

Select Value is an actively managed multi-cap equity strategy that seeks long-term capital appreciation. Portfolios include both dividend and non-dividend paying stocks and broad diversification is sought via exposure to a significant number of major market sectors and industry groups. Portfolios are constructed initially with positions across 60 to 80 individual holdings

[Select Value](#)

Select Dividend Value is an actively managed equity strategy that primarily seeks long-term capital appreciation, with a secondary emphasis on current dividend income. Portfolios include primarily dividend paying stocks. Broad diversification is sought via exposure to a significant number of sectors and industry groups. Portfolios are constructed initially with positions spread across 40 to 60 individual holdings.

[Select Dividend Value](#)

Investment Process

In our pursuit of broadly diversified portfolios of undervalued stocks, we qualify stocks as undervalued using a bottom-up assessment that relates financial, operational and economic fundamentals to current and potential future market value.

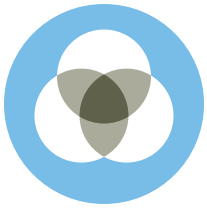
Filtering from a large universe of stocks for inclusion in our proprietary database of companies built and maintained over the firm's long history, fundamental analysis of companies begins from the bottom, on a company-by-company basis, influenced by macroeconomic and industry-wide data. These fundamentals and trends are distilled into long-term expectations that are applied against our determination of fair value multiples of sales, earnings and book value to produce a fair-value target price for each stock in our database.

We search for stocks that are trading at substantial discounts to our calculation of their long-term, three to five-year fair valuation price target. Every company and industry has its own set of normal valuation measures, but we look for those stocks that are trading at lower price-to-earnings ratios and/or lower price-to-sales ratios and/or lower price-to-book value ratios and/or lower enterprise value-to-EBITDA or have solid balance sheets with little or no debt and substantial cash and investments, among other measures of relative value.

Through these analyses we generate a list of stocks available for purchase while also identifying those stocks that warrant a sale due to sufficient appreciation or from deterioration in our fair value determination.

Investment Process (cont.)

Components of the research process



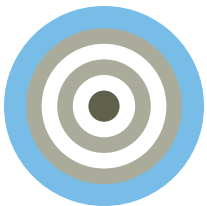
Quantitatively Filter Universe of 6,000+ Companies

Identify stocks with some combination of low valuation multiples—including price-to-earnings, price-to-sales, enterprise value-to-EBITDA and price-to-book value, low debt levels, large cash stores and strong growth, past or potential.



Qualitative Evaluation

Examine company financial statements; Analyze industry trends; Assess company-specific prospects; Evaluate financial, operational and market risks and opportunities.



Establish Purchase Limits & Target Prices

Review historical valuation metrics; Assign 3- to 5-year prospective valuation 'norms'; Buy when trading for significant discount to our fair valuation price and reward relative to downside risk is favorable.



After Care—Ongoing Analysis

Consistently monitor company, industry, market and economic developments; Avoid emotional reactions to short-term positive or negative news; Adjust target prices as events warrant; patiently hold when prudent.



Sell Discipline

Primary rationale driving sell decisions: Stock reaches or approaches fair valuation price; Lower valuation estimate results from reassessment of earnings or valuation multiples; Downside risk becomes too great relative to upside potential.

Risk management

Combining to mitigate risk are 1) broad portfolio diversification across holdings, sectors and market capitalizations, 2) long-term investment time horizons, and 3) a consistent selection methodology focused on buying stocks with inexpensive fundamental valuations. For example, at the end of February 2011, our largest single position represented 1.4 percent of total assets under management and our top 10 positions represented 12.1 percent of total assets.

Utilizing the same basic investment approach that the firm has employed for 34 years, we operate within a team concept that is overseen by the Chief Investment Officer with broad reliance on technological (FactSet Research Systems, ClariFI, and others) and human resources. In regard to the latter, our investment team consists of four employees with many years of industry experience, all of whom contribute analytically to the investment process, thus reducing the dependence upon any one individual.

That team approach carries over to portfolio management as well, with more than one portfolio manager reviewing an account over time and a dedicated trader often placing the individual orders. Neither individual decisions nor overall portfolio performance are attributed to individual portfolio managers, significantly reducing the possibility of an individual taking excessive risk in a portfolio for personal gain or recognition.

Allocation method **Trading**

On the occasion we purchase or sell the same security at a given time for multiple accounts, we utilize a rotational order execution and trade allocation system based on the alphabet. The sequence in which orders of directed and non-directed accounts are placed with brokers is determined alphabetically and then reverse-alphabetically. The sequence of trades is first determined by sorting broker-dealers and then sorting clients by internal client code. The objective of this procedure is to ensure that no client receives special consideration when trades are placed with brokers. Block orders may be used when it is in the best interest of each client participating in the order. Partially filled bunched orders are allocated to the least-invested account when purchasing and the most-invested account when selling.

Primary Broker-Dealer relationships

We strongly encourage clients to use Charles Schwab & Co. or Fidelity Investment. Clients who direct their brokerage to a provider other than Charles Schwab or Fidelity may be charged a higher management fee by AFAM and may pay higher commissions in some instances, depending on AFAM's ability to negotiate commissions, obtain volume discounts or best execution from the broker selected. Clients are responsible for verifying that they are receiving best execution if they direct their brokerage to a provider other than our recommended brokers. Brokers are selected principally on the basis of their commission rates and quality of execution and service, not on the basis of any products, research or "soft dollars."

Performance Benchmarks

Comparing actual composite composition over time with various U.S. equity indices should result in the identification of a benchmark index that best represents the universe of stocks from which strategy holdings are chosen. Noting 1) the market-cap breadth of the universe from which we choose stocks, and 2) our predilection for relatively undervalued shares, we have chosen the Russell 3000 as the preferred benchmark for the firm's products. The Russell 3000 Index measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market.

About the Firm

We are governed by our Board of Directors who takes its primary direction from the Executive Management Committee and Business line managers. Jeff Montgomery is the firm's Chief Executive Officer, with primary responsibility over operating strategy development and execution, corporate operations and business development. John Buckingham is the firm's Chief Investment Officer with primary responsibility over the firm's portfolio management and research efforts. Kurt Morales is the firm's Chief Financial Officer with primary responsibility over financial management. Duane Mattson serves as the Chief Compliance Officer. Paul Osterberg is the Chief Marketing Officer. Key team members on the investment team include: Mark Mowrey, Jason Clark and Jessica Chiaverini.

Structure

Key personnel

Jeff Montgomery, as Chief Executive Officer, is responsible for AFAM strategy, operations and sales. Prior to joining AFAM in May 2008, Jeff most recently served as President and CEO of NFP Securities, Inc., a FINRA-member broker-dealer and registered investment advisor with more than 1500 producers, Jeff has been working in the asset management industry for 19 years.

Executive

John Buckingham, Chief Investment Officer, leads a team that scrutinizes hundreds of stocks for money management clients and subscribers to *The Prudent Speculator* investment newsletter, of which he is the editor. He is equally resolute in his management of Al Frank's proprietary mutual funds. John has been a part of AFAM since 1987 and is one of the company's largest shareholders. He has served as the firm's Director of Research since 1989 and Chief Portfolio Manager since 1990. John graduated magna cum laude from University of Southern California in 1987 with a B.S. degree in computer science and a minor in business administration. His opinion is widely sought. John has appeared on numerous television and radio programs, is frequently interviewed by publications and conducts workshops at investment seminars.

Paul Osterberg, Chief Marketing Officer, is responsible for AFAM marketing. Prior to joining AFAM in November 2008, Paul most recently served as a Senior Vice President in a diversity of roles at NFP Securities, Inc. Prior to joining NFP Securities, Paul consulted to numerous financial services companies while employed at Deloitte Consulting. His clients included ING, Ameriprise, Nationwide and Wells Fargo. Paul has been working in the financial services industry for 21 years.

Scott E. Silverman, CIMA, SVP, Business Development joined AFAM in 2009. Scott received a BS in Marketing from the University of Arizona in 1998. Most recently he was Regional Director at William Blair & Co. from 2004 – 2009.

Duane Mattson, Chief Compliance Officer, has been with AFAM since April 2010. Duane received his B.A. degree from the University of Minnesota in 1988 with a major in journalism. He served as Chief Compliance Officer for Austin Capital Management from 2008 to 2009 and was employed by NFP Securities in a variety of positions from 2005 through 2008, including Chief Supervisory Officer.

Kurt Morales, Chief Financial Officer, joined AFAM in July 2010. Prior to joining AFAM, he served as Principal Accounting Officer and CFO/FINOP at Tejas, Inc. and Tejas Securities Group, Inc., respectively. Mr. Morales began his career with KPMG Peat Marwick in Austin, TX, and served as Controller/FINOP at NFP Securities for five years. He holds both a Bachelor's and Master's degree in accounting from the University of Texas at Austin and has earned his Certified Public Accountant designation from the Texas State Board of Public Accountancy.

Research & Portfolio Management

Mark Mowrey, CFA, Senior Vice President, Investment Strategy at AFAM | Innealta, has been a member of the firm's Research and Portfolio Management Team since 2004. Mark is a member of the firm's Management Committee. Focused primarily on more quantitative approaches to investment management, Mark addresses research topics ranging from the past and expected future performance of individual securities based on unique combinations of fundamental characteristics, to the evolving macroeconomic environment's impact on the firm's various investment strategies. Mark graduated from the Wharton School of the University of Pennsylvania in 1994. Prior to joining the firm, Mark served as the Director of Research at Red Herring Communications, a technology and finance-related magazine publisher. Mark's background includes work as public equity research analyst, a financier in private equities, a consultant and an entrepreneur. Mark is a CFA Charterholder.

Jason Clark, CFA, Assistant Vice President, Portfolio Management, is a member of AFAM's Investment Committee. Jason has been a part of the firm's Research and Portfolio Management team since 2007. Within research, Jason is primarily focused on fundamental analysis of individual stocks and industries. Within Portfolio Management, Jason is responsible for active account management, providing education about the firm's investment strategies and portfolio management process and working with the firm's current and prospective Private Wealth clients. He also contributes to the firm's newsletter and Market Commentaries. After serving in the United States Navy, Jason graduated summa cum laude

with a B.A. degree in finance from the University of West Florida. His background includes experience as a fixed income specialist and corporate bond trader for Edward Jones and equity research associate with A.G. Edwards. Jason is a CFA Charterholder and a member of the CFA Society of Orange County.

Jessica Chiaverini, Portfolio Manager, is primarily responsible for managing portfolios and providing service to managed account clients. She is involved in equity analysis and research, and writes commentary for the firm's newsletter. Jessica's credentials include a B.S. degree from Lehigh University in 1992 and six years of experience as Junior Analyst and Assistant Portfolio Manager at Brundage, Story & Rose, LLC. She then managed client services at Iverson Financial Systems, Inc. before joining AFAM in June 2000. Jessica is a Registered Investment Advisor Representative.

To find out more, contact us at 888.994.6837 or visit us at alfrank.com

Important information

Al Frank Asset Management (AFAM), Inc is a registered Investment Advisor, is editor of *The Prudent Speculator* newsletter and is the Investment Advisor to two value-oriented proprietary mutual funds and individually managed client accounts.

AFAM adheres to the same investment principles and philosophies in managing individual client accounts, its proprietary mutual funds and in the information that appears in its investment advisory newsletter, which is long-term growth of capital by owning a diversified portfolio of securities that are undervalued and holding them for their long-term potential appreciation.

Diversification does not assure a profit or protect against a loss in a declining market.

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