

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Investing in Mid-Cap Growth Stocks



MICHAEL BORGEN, a Portfolio Manager at Navellier & Associates, has nine years' experience in the securities industry and joined Navellier in 1995 as a Quantitative Research Analyst. Mr. Borgen is currently responsible for the management of the Mid Cap Growth and Micro-to-Small Cap Growth strategies and was named Lead Portfolio Manager for the Small Cap Growth strategy. In addition, Mr. Borgen conducts ongoing research enhancements of the firm's quantitative investment process and works on product development. He received a BS in Finance from the University of Nevada, Reno.

(YAJ500) TWST: Would you tell us about Navellier & Associates and what you do there?

Mr. Borgen: Navellier & Associates is a registered investment advisor headquartered in Reno, Nevada. Navellier has a variety of investment vehicles ranging from mutual funds to managed accounts. We at Navellier tend to focus on the growth side of the equity market, although we do have a couple excellent value portfolios as well.

Although Navellier & Associates has traditionally been seen as a small cap growth specialist, over the past eight years we have branched out into several different market segments including the mid-cap growth and large cap growth market segments. In fact, as of September 30, 2004, our Mid Cap Growth and Large Cap Growth Portfolios combined represented approximately 60% of our total assets under management.

We at Navellier are generally regarded as a quantitative investment management firm. This reputation was developed as Louis G. Navellier, our founder, CEO and CIO was a pioneer in the realm of quantitative investing. Mr. Navellier began his career publishing his quantitative research in his MPT Review Newsletter in 1985. Today the tradition of Mr. Navellier's quantitative investment style

continues at Navellier & Associates, as our quantitative analysts and portfolio managers continue to develop new and innovative quantitative stock selection models.

At Navellier & Associates I am chiefly responsible for the management of our Mid Cap Growth Portfolio our Small Cap Growth Portfolio, and our Micro to Small Cap Growth Portfolio.

TWST: Do you do any top-down analysis of the economy or the market?

Mr. Borgen: No, we do not. We are strictly a bottom-up quantitative investment firm. At Navellier, we have a three step quantitative modeling process.

In our first step, we measure a stock's reward to risk characteristics and the top 20% of stocks based on this criterion are selected to continue to our second step. The second step involves focusing on the stock's fundamental data. For example, we tend to focus on variables such as earnings growth, sales growth, or return on equity. In order to continue on to the third step in our process, portfolio construction, stocks must have high reward to risk characteristics and higher than average fundamental qualities. In our third step, portfolio construction, we utilize an optimization model to help us structure a portfolio with the highest risk-adjusted return qualities.

The main difference between our portfolio optimization method and the optimization method of other managers is that we do not attempt to limit tracking error to our target benchmark. As a result, we tend to have a higher than average tracking error, which means that our portfolio, although style pure, can behave differently from the benchmark we are being measured against. Over the long run this approach has enabled our portfolios to significantly outperform both our benchmark and our peer group.

TWST: What is the environment like for your mid-cap stocks? These days we hear a lot about large cap stocks in the ascendancy right now.

Mr. Borgen: Although large cap stocks might be getting all the press, mid-cap stocks according to the performance of the Russell Midcap Index are actually outperforming both the Russell 2000 (small cap) Index and the Russell 1000 (large cap) Index year to date through October 31, 2004. Year to date the Russell Midcap Index is up 8.69% versus 5.57% for the Russell 2000 Index and 3.10% for the Russell 1000 Index.

As bull markets progress, typically performance creeps up the capitalization ladder, and although a lot of people are talking about large cap, right now I see better performance in the mid-cap area. Unfortunately, many professional and individual investors alike overlook the importance and return potential in the mid-cap market segment.

Currently, the mid-cap market segment has loads of return power, and as the bull market progresses, we anticipate that excess return eventually reaching into the large cap market segment; however, we anticipate that relative strength will continue in the mid-cap market segment for the foreseeable future.

folio outperformed the Index. As the market continues to focus more on stocks with superior fundamental characteristics, our relative performance continues to excel.

TWST: What are some of your sector weightings compared to the benchmark?

Mr. Borgen: Due to our quantitative bottom-up stock selection process, all of our sector weightings are actually a result of our stock selection process. As of the end of September our technology, energy and consumer staple sector weightings were at 25.22%, 10.63% and 6.19% versus 18.82%, 5.03% and 2.71% respectively for the benchmark. On the flip side, our weightings in finance, consumer discretionary and durables sectors were 2.19%, 17.08% and 3.36% respectively versus 12.15%, 24.5% and 8.49% respectively for the Index.

TWST: What are some of your recent purchases in your overweight sectors, and why were you attracted to them?

Mr. Borgen: Over the past several quarters most of our purchases have been predominantly in the energy area of the market, and for a very good reason. As the price of oil has been expanding over the past year or so, profits in many oil-related companies have been expanding. Many of these oil related companies have some of the highest earnings growth in the market right now. Since expected earnings growth and other growth-oriented variables are so prominent in our quantitative fundamental model, a sector such as the energy sector where companies rely so heavily on the price of a commodity and to less of an extent on proprietary technological advances, most stocks in this sector have benefited from the rise in oil prices and as such have captured more investor capital. Stocks such as **XTO Energy** (XTO) and **Sunoco** (SUN) and **Kerr-McGee** (KMG) are very highly rated in our model right now.

“Over the past several quarters most of our purchases have been predominantly in the energy area of the market, and for a very good reason. As the price of oil has been expanding over the past year or so, profits in many oil-related companies have been expanding. Many of these oil related companies have some of the highest earnings growth in the market right now.”

TWST: Since we last spoke to you, how has the performance of your Fund been, compared with your benchmark?

Mr. Borgen: Relative performance has steadily improved relative to our benchmark the Russell Midcap Growth Index, and our peer group. September ended the third quarter in which our portfolio handily outperformed both the Index and our peer group average and put the portfolio ahead of the benchmark by approximately 1% year to date. September also marked the fifth month in a row that the port-

TWST: What about your other areas? What other stocks can you tell us about?

Mr. Borgen: In the technology area we've been adding to our positions in stocks such as **Autodesk** (ADSK) and **Adobe Systems** (ADBE). I'm sure everyone is well aware of the Acrobat program. **Adobe** seems to own the desktop publishing market. Another great winner for us continues to be **Symantec** (SYMC), and we continue to hold this stock and it continues to do very well for us.

TWST: It's unusual to find consumer staple stocks high up on a growth portfolio. What have you been looking at lately?

Mr. Borgen: In the consumer staple sector we are holding household name stocks such as **Hershey Foods (HSY)**, **McCormick (MKC)** and **Whole Foods Market (WFMI)**.

TWST: What are some of the core holdings that you have that you've held onto for a long time?

Mr. Borgen: Our core holdings list spans the sector spectrum. **Aetna (AET)** continues to be a solid performer despite the sector's overall malaise. Another couple of core holdings are **Biomet (BMET)** and **St. Jude Medical (STJ)**. As I previously mentioned, **Symantec** continues as a long-term holding as well as **Adobe Systems**.

TWST: Where would you put new money and lots of capital coming in to work in your portfolio?

Mr. Borgen: We are actually in the process of deploying new capital and we are adding to our weighting in the consumer discretionary sector of the market.

“Currently, the mid-cap market segment has loads of return power, and as the bull market progresses, we anticipate that excess return eventually reaching into the large cap market segment; however, we anticipate that relative strength will continue in the mid-cap market segment for the foreseeable future.”

TWST: Which is an underweight at the moment.

Mr. Borgen: Correct, we are in the process of increasing our percentage in the consumer discretionary.

TWST: What's your thinking behind that?

Mr. Borgen: Due to our quantitative system, stock-specific issues are the main driver of portfolio allocations. Many of the stocks in that area are starting to see very powerful earnings growth, particularly in the higher-end retailing and teen retailing industry groups. Although many lower-end retail companies have felt the pain of higher oil prices, the higher-end retailers and retailers that focus on the teen market segment have continued to perform well.

TWST: Do you ever invest in turnaround situations?

Mr. Borgen: Turnaround investing doesn't fit our style of management. Typically we want to make sure that we're buying strong performers that have solid earnings growth, solid sales growth, and solid operating margins. So the turnaround game is really not an area that we participate in.

TWST: What is the sell discipline?

Mr. Borgen: Many people can pick stocks that go up; the hard part is knowing when to sell. We've found that the reverse of our buy discipline works well as a sell indicator. Our buy discipline

is a three step process: first, our reward/risk step; second, solid fundamental characteristics; and third, portfolio optimization. Our sell criteria are simply that a stock has to fail one of the three steps.

TWST: What was the last stock you sold and why?

Mr. Borgen: The last stock I sold was **Electronic Arts (ERTS)**, which was a long-term holding in the Fund. The volatility recently started to pick up and its alpha started to decline slightly. So although it remains a very good candidate and continues to be a great company, there are just other stocks out there in our universe that looked more attractive at the time. We often sell a good stock to buy a better stock.

TWST: What is the impact of volatility when you look for the alphas? Can you talk about the volatility factor and how you protect yourself against it?

Mr. Borgen: Risk-adjusted alphas are one of the reasons why our process does so well in long-term trending bull markets and also relatively well in long-term trending bear markets. During a long-

term trending bull market, we typically will see some stocks that have enormous alphas, and the stocks with massive alphas can support extremely high volatility. Therefore, during a long-term trending bull market, our system tends to gravitate toward the high return potential volatile names in our universe. Conversely, during a long-term trending bear market, stocks tend to have significantly smaller alphas, therefore, smaller alphas can support significantly lower volatility and our system will tend to gravitate toward stocks with more reasonable reward/risk characteristics with great growth potential. We're still looking for those high alpha stocks in a bear market, and those high alpha stocks can support smaller standard deviations. Consequently the volatility of our portfolios drops dramatically during a bear market environment. During our last bear market, our portfolio volatility was at times half that of the Russell Midcap Growth Index.

TWST: Since your firm is in Nevada, do you have any gaming stocks that you found on your screens? Do you still have IGT?

Mr. Borgen: Yes, we continue to hold **International Game Technology (IGT)**. Its alpha has declined slightly over the past several months; however, it's still holding up. Right now it's ranked as a hold in our system, and we are following it more closely.

Another stock gaming stock is **Mandalay Resort Group** (MBG), which we recently sold because it's a buyout situation.

TWST: Can you tell us about your client base and what type of investor is attracted to this kind of mid-cap growth fund and what their expectations are?

Mr. Borgen: Our client base for the Mid Cap Growth Portfolio is very diverse; approximately half of our mid-cap growth clients are institutional clients the other half being retail clients.

TWST: What sets your Fund apart from many of the mid-cap growth funds at other firms?

Mr. Borgen: At Navellier we pride ourselves on our disciplined quantitative modeling process. Emotion never clouds our judgment as it may at other firms that invest utilizing a different system. Our process is clean, straightforward and relatively easy to understand and explain. I believe that this is what often sets our system apart from other firms.

TWST: In what type of market or volatility scenario does your Fund do better, and when does it underperform?

Mr. Borgen: Our system is typically going to outperform both the benchmark and peer group averages during longer-term trending markets. Our system will typically underperform in two types of situations, first where there is a tremendous amount of volatility and not a discernable pattern in the market, such as in 2001, where we trailed the benchmark by about 2%. From a modeling perspective, 2001 was our most difficult year despite only trailing the benchmark by 2%.

The second major type of market where we have tended to underperform the benchmark are those short market cycles where low quality stocks tend to lead the market higher, such as the market performance from the fourth quarter of 2002 through the first quarter of 2004, about a year and a half. Over longer periods of time, higher quality stocks always will outperform and positive relative performance returns to our portfolio.

TWST: Now that the dividend tax cut appears to be permanent with President Bush being re-elected, might you invest in a company because of its yield, perhaps where yield might be the swing factor for you?

Mr. Borgen: We continue to test the dividend yield and other dividend factors, and they have yet to actually produce value in our growth-oriented system. Although I believe certain dividend-based models are being utilized in a couple of our value-biased, quantitative modeling systems.

TWST: What would you say is the biggest question mark or concern that you're grappling with that might impact your investment approach going forward? Is there anything you foresee, such as higher interest rates?

Mr. Borgen: I don't foresee interest rates climbing dramatically over the next year or so. I see them gradually increasing, but at a pace the economy can absorb, and returning to more of a neutral stance. Despite my view on what the Federal Reserve Board is or isn't going to do, our quantitative modeling process doesn't reflect those biases and will continue in the fashion it has so successfully demonstrated for the past eight years.

TWST: What advice would you give to investors who are looking to invest in mid-cap stocks at this time? Is it a stock-picker's market? Why would they be wise to select mid-cap growth?

Mr. Borgen: It absolutely is a stock-picker's market, as many of managers have noticed. Right now I would advise investors who are looking at investing in the mid-cap market to look at active managers that are not closet-indexing. I would also advise against necessarily looking at a manager's return over a trailing one- or two-year period as an indicator of a manager's true skill. For example, many managers who did very well in 2003 on average experienced below average performance during the preceding three years. I would highly suggest that investors research the portfolio processes of numerous managers and invest with the manager who they feel has produced solid long-term performance combined with a logical investment methodology.

TWST: Thank you.

Note: Opinions and recommendations are as of 1/21/05.

MICHAEL BORGEN
Navellier & Associates
One East Liberty Street
3rd Floor
Reno, NV 89501
(775) 785-9440