

EQUITY FUND OUTLOOK

A Guide to the Best-Managed Stock Funds

EQUITY FUND RESEARCH

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A BRIEF GUIDE To EQUITY FUND OUTLOOK

EQUITY FUND OUTLOOK is a monthly newsletter for fund investors who want to achieve above average growth, minimize risk and avoid intense trading. Its approach combines careful fund selection based on analysis of reward/risk characteristics with consideration of prevailing market risk. The emphasis is on identifying funds with the best managers.

THE MARKET

EFO is not a market timing service, but each issue starts with an assessment of risk in the market, particularly how over-bought it is on a long-term basis. Our measure of the market, the EFO Market Index, is composite of the NYSE, OTC and AMEX indices. The Market Indicators box summarizes risk, trend and valuation readings of the market as a background for the discussions to follow.

FUND ANALYSIS

EQUITY FUND OUTLOOK fund analysis is based on comparing potential performance, exposure to risk, and relationship between reward and risk. Relative measures are computed for each of these characteristics based on 10 for the Wilshire 5000 (with dividends). Diversified funds are classed as higher risk, market risk or lower risk, depending on actual behavior.

Identifying Growth Potential

More often than not diversified funds that have been strong performers in rising markets over the recent years have a good chance of being strong performers in the next rising market period. So EQUITY FUND OUTLOOK shows an average of relative performance for twelve most recent up-market periods to get an idea of which funds will do best in the next up-market periods. The resulting measure we term "Growth Potential." A growth potential of 10 is equivalent to the market. So a growth potential of 15 means that the fund has averaged 50% more growth than the market in recent rising periods. A growth potential of 7 means that the fund has under-performed the market during rising periods by 30%.

Taking Note of Fund Risk

Fund risk exposure is shown as an average of up to six declines relative to the EFO Market Index during market drops within the last three years. Also included in this calculation is the relative volatility (standard deviation) for the past 3 years. This dual approach has proved to be an excellent way to predict how much more or less risk a fund will experience than the market. A risk exposure of 15 means that the funds is likely to decline 50% more than the market in a market decline. A risk exposure of 7 means the fund is apt to drop only 70% as much as the market in market reverses.

Reward/Risk Analysis

Funds with less risk for the same level of growth potential we call are considered to have a high "investment skill quotient" (ISQ) and will receive higher ratings, all else being equal. ISQs are shown next to growth potential and risk exposure in the Fund Survey pages and the last page list of funds by rating within class.

This concern with reward as adjusted for risk is one of the most important features of EQUITY FUND OUTLOOK as it is very helpful in making investment decisions you can live with for a while.

MODEL PORTFOLIOS

EFO maintains TAX-ADVANTAGED and TAXABLE model portfolios suitable for market-risk investors. Suggestions are sometimes provided to modify holdings for aggressive and conservative investors. For the taxable portfolio trading is less frequent and tax-efficient funds are favored.

Each portfolio's overall risk exposure is determined by figuring a weighted average of each fund's risk level (where cash is zero). Similarly, its weighted average growth potential is shown and may suggest that a portfolio needs upgrading if this value lags behind the reader's objective. These portfolios have been covered in *The Hulbert Financial Digest* since 1991 and were previously run as "Moderate Risk" and "Conservative" portfolios with no distinction as to tax status.

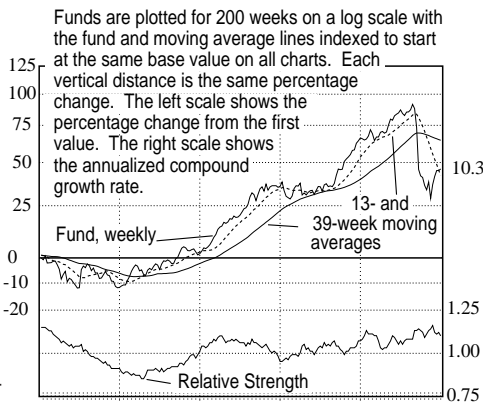
Wish Lists

Funds listed here are suggestions for those building a tax-advantaged or taxable portfolio from cash at time of publication and are designed for do-it-yourself investors.

CHARTS

Charts of some of the funds under discussion are presented to assist in evaluating for purchase or sale. Fund charts in EQUITY FUND OUTLOOK are especially easy to compare to other funds and

the market. One reason is that the fund price line (with all distributions reinvested) is indexed to start on the same base line for each chart. Where the plot ends tells you how well it has done over the 200-week period. This price line is then plotted on a semi-log scale such that each vertical distance reflects the same percentage change. Most useful of all perhaps is the relative strength line (RSL) plotted at the base of most charts. This plot is a measure of how the fund has been doing vs. the market.



FUND SURVEYS For reports on pages 5 - 10.

Fund names are preceded by group code as listed in the *Directory*. More complete explanations of terms are in the *Guide* sent to new subscribers.

Brokerage availability Fidelity, Schwab or TD Waterhouse

Same Manager Since/Distribution Pattern:

Year current manager took over.

A # means a distribution is probable before the end of this or the next month.

Distribution frequency:

A annual M monthly
S semi-annual Q quarterly

Tax Impact: A measure of % loss in annual return from federal taxes on distributions.

Expense Ratio: Most recent annual expenses as a percentage of average total net assets.

Portfolio Turnover Rate: Annual, as a percentage of total fund assets.

Performance and trend: Percentage change followed by arithmetic moving average trendline direction; arrows are bold when the arithmetic and exponential trends agree.

Portfolio characteristics:

-Size of firms: Capitalization of the median stock in the fund: Large, Mid, Small or Any / all size firms.

-Stock selection style: Growth- manager seeks earning growth above other criteria; Value- manager seeks undervalued firms; B fund uses blend of growth and value.

Index- fund tried to duplicate an index.

-Diversification: from aa (concentrated) to ee.

-Cash position: blank (< 5%), ¢ (6 to 15%), or \$ (>15)

-Market correlation: Measures of how much a fund moves with the NYSE and the OTC markets. Range is 0 (nil) to 9 (strong) or contrary (-).

-Size of assets: A (small) to E (very large)

-Financial health and technology weightings: 0 (nil) to 9 (heavy)

Investment-skill Quotient (ISQ): A measure of reward / risk and management skill computed by dividing Growth Potential by Risk Exposure. 10 is a norm (neutral).

Ratings: Based on 75 as a norm, ratings are calculated for each fund based on its class. Values above 85 are usually good buy candidates. **Values below 65 are SELL / AVOID signals.** The second rating is for taxable accounts and reflects tax impact from distributions.

FUND RATINGS

Growth potential, risk exposure and efficiency are the primarily components of fund ratings. But we also consider tax exposure from distributions, expense ratio, moving average trends for several periods and chart patterns. Tables of ratings factors and other useful information on about 120 of the most promising diversified funds are shown in each issue.

If you are making your own decisions, the ratings will keep your portfolio in tune with the best funds the marketplace has to offer for your risk preference. This is because readers can easily figure the weighted average characteristics for their own portfolio by using the growth and risk figures for each fund the own. These values are found on the last page, which sorts funds by overall rating within their risk group or specialty classification. Comparing these values with the recommended range of risk levels for your risk class is the first step to determine what kind of action to take.

OTHER ESSENTIALS

Subscribers receive a complete GUIDE and a DIRECTORY with features and performance for recent years for all funds covered; and the telephone number of the HOTLINE, which can be sent via e-mail. And online access to the EFO website (www.equityfundoutlook.com) for current and past issues, a weekly update on fund performance, and ratings, and EFO fund statistics for reader's own spreadsheet analysis.

About the editor

Thurman Smith, editor of EQUITY FUND OUTLOOK, has been managing money for clients using no-load growth funds since 1980. Previously, he was with Fidelity Investments as a systems analyst, applying twelve years of experience in financial and investment applications to their computerized research efforts. He is author of *Investors CAN Beat Inflation* (1980, McGraw Hill/Tab Books), has written articles on fund investing for several national magazines. He is regularly quoted in such publications as *Kiplinger's*, *MONEY*, *Barron's*, and *The Wall Street Journal*. Mr. Smith holds an MBA in finance and investments from Babson College.