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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Conservative & Flexible Active Portfolio Management

SEAN CHAITMAN is the Chief Investment Officer of Shelter Rock Management, LLC. Mr. Chaitman has two decades of buy- and sell-side investment experience as a Portfolio Manager and Research Analyst. Prior to founding Shelter Rock Management, he was a member of the investment team of Heirloom Capital Management, a long and short investment fund with assets in excess of $650 million. He was responsible for global telecommunications, media, technology and special situations investments. He was also a member of long and short investment fund Zinc Capital Management, where he focused on technology investments and special situations. Mr. Chaitman was formerly a Senior Equity Research Analyst at Jesup & Lamont Securities Corporation, and he was a member of Smith Barney's value stock research team. He has an MBA from Columbia Business School and a B.S. in economics from the University of Wisconsin at Madison. For his investment work, Mr. Chaitman has been ranked by Reuters as a top 10 small- and mid-cap electronics analyst, and he has been quoted and featured in *The Wall Street Journal*, *Investor's Business Daily*, *Forbes* and *The Wall Street Transcript*.

SECTOR – GENERAL INVESTING

TWST: Introduce us to Shelter Rock Management and tell us about the services and portfolios it provides.

Mr. Chaitman: We are a registered investment adviser. We are based in Lake Success, N.Y., which is about a half an hour outside of New York City. We provide active portfolio management and customized asset allocation for high-net-worth institutional and our corporate clients. Most of our clients have their accounts at Fidelity Investments, and they are invested in one or more of our four investment strategies. Our most conservative strategy we call the Strategic Income Strategy; it's a portfolio of individual corporate bonds that mature in five years or less. For this strategy, we are looking to generate a positive return over every future two-year period and to always beat what you can earn on government bonds, CDs and money markets over the same horizon. At the opposite end of the spectrum is our most aggressive strategy that we call the Opportunity Strategy. That strategy is benchmarked against the S&P 500, and it typically consists of a portfolio of up to 20 domestic large-cap value stocks. Then we have two other strategies. One is a Moderate Strategy and the other is a Moderately Conservative Strategy. Those two strategies are primarily invested in mutual fund portfolios, but they do have some individual stocks as well.

For our corporate clients, we provide open architecture 401(k) plans, and that service ties into our mutual fund research. We partner with 401(k) administration companies including Paychex (PAYX), where we create the menu of mutual funds for our client's retirement plans, and then we monitor the funds and provide financial advisory to plan participants. Paychex performs all of the plan's administration and their web site is used by clients to manage their 401(k) plans. Open architecture 401(k) plans have significant advantages versus most other plan types since they are low cost and the investment selection has the potential to be very high quality. Since it's an open architecture, we have the ability to pick from thousands of different mutual funds when we create an investment menu for our clients.

TWST: On the 401(k) plans, is that an active portfolio management as well, or is it more like a traditional 401(k) where people pick their funds and investments?

Mr. Chaitman: It's a traditional 401(k) plan. However, as I previously mentioned, where an open architecture plan is different – and this is where it is really different – is because it's an open platform, we have an unusually large selection of mutual funds to choose from when we create a menu of up to 60 or so mutual funds for plan participants. We are actually able to pick a full roster of top-performing five- and four-star mutual funds rated by Morningstar from different investment categories. Most 401(k) plans we've come across have a limited mutual fund selection, and that compromises the returns for the plan participants. The limited fund choices are actually one of the most common complaints about 401(k) plans. So from that perspective, our plans are unique. We don't actively manage 401(k) accounts but do create aggressive through conservative mutual fund portfolio models that participants can follow.

Highlights

Sean Chaitman, who has a breadth of experience on both the buy and sell sides, describes Shelter Rock's actively managed portfolios for high-net-worth institutional investors in addition to the firm's 401(k) plans for corporate clients. He describes his investment philosophy as conservative and flexible, highlighting the benefits of being an independent registered investment adviser. Mr. Chaitman discusses several of his current favorite investment stories as well as some of the lesser-known bonds in which his portfolios are invested. He offers advice on managing volatility and adjusting to long-term uncertainty in the market.

Companies include: AT&T (T); Yacktman Fund (YACKX); The Coca-Cola Company (KO); Clorox Corp. (CLX); Johnson & Johnson (JNJ); Osterweis Strategic Income (OSTIX); Permanent Portfolio (PRPFX); Cablevision Systems Corporation (CVC); Liberty Media Corporation (LINTA); The AES Corporation (AES); Teva Pharmaceutical Industries Ltd. (TEVA); Wendy's/Arby's Group (WEN) and Kinder Morgan Energy Partners LP (KMP)

TWST: Tell us more about yourself. I know you have a varied background on both the buy and sell sides.

Mr. Chaitman: That's right. The last time I spoke with *The Wall Street Transcript*, I believe it was back in 1999, and at that time I was a Senior Research Analyst at Jesup & Lamont Securities. I covered small-cap technology stocks. I spent most of the 1990s working on the sell side in equity research at companies like Jesup & Lamont and Smith Barney, publishing research recommendations to mutual fund and hedge fund portfolio managers. I migrated to the buy side over the last decade, and I worked as a Portfolio Manager and an Analyst since that time. Before founding Shelter Rock Management in 2006, I spent a number of years working for some very smart and seasoned investment professionals at long and short equity investment funds. I was able to invest in hundreds of stocks from different industries, using value and growth processes. I worked for a former Gabelli professional who invested using a deep value process. I worked for a fund owned by portfolio managers who previously ran some large growth mutual funds for Investors Group, and we used a growth-at-a-reasonable-price and opportunistic trading strategy. After that I was recruited to join a fund called Heirloom Capital, which was owned by a former BlackRock mid-cap growth mutual fund manager. That fund used a growth and momentum strategy. Since 2006 I've been responsible for the investment strategies at Shelter Rock Management.

TWST: How does that experience help your clients in what are you doing now?

Mr. Chaitman: The first thing is I have always personally been passionate about investing. When I was a sell-side analyst, I had a reputation as a top stock picker, and this followed me to the buy side. Picking top mutual funds is similar to picking stocks and bonds, since mutual funds are portfolios of stocks and bonds, and the research involved for picking high-yield and convertible bonds is similar to stock picking. Since I spent a decade on the sell side and buy side and was able to research so many different types of companies using value, growth and other processes, my experience is beneficial to our clients for making the right choices and for us being able to adapt to the different types of markets that we're faced with. As you know, there is a lot of news that comes out every day, different economic statistics, industry news and company-specific news. So being able to understand what's important and what's not is very relevant, and knowing what trends to watch and how to analyze them is also important for making the right choices.

I'm happy to give you an example if you like, or we can move on.

TWST: Sure.

Mr. Chaitman: In the second quarter of this year, we reduced our risk exposure in our strategies because we became uncomfortable with the macro economic events that we felt could pressure the financial markets in the months ahead. We were seeing European sovereign credit stresses beginning to affect our credit markets here in the U.S. We saw this since we manage an individual bond strategy, so we watch our credit markets very closely. The corporate bond borrowing credit spreads were widening, and it became evident to us that this would cause U.S. business owners to slow their spending plans from the uncertainty, and that would cause our economy to decelerate. At that time, we reduced our small-cap exposure in our equity strategies, since small caps underperform certain large caps during slowing economies, and we rotated into more defensive recession-resistant type of large-cap value stocks that typically outperform in that scenario. We added AT&T (T) shares to our equity strategies, and we added mutual funds that invest in more defensive type of stocks, like the **Yacktman Fun**d (YACKX), which owns companies like **Coca-Cola** (KO), **Clorox** (CLX) and **J&J** (JNJ). We also increased our cash and fixed income weightings in our moderate and moderately conservative strategies. These decisions helped preserve capital for our clients in the recent difficult months, and they are part of the reason why our strategies have been outperforming.

"When we are saying conservative, what we mean is that whenever we evaluate a new investment, we always first approach it from the standpoint of what can go wrong and what's our downside risk."

TWST: Tell me about your investment philosophy. I know you've called it conservative and flexible.

Mr. Chaitman: When we are saying "conservative," what we mean is that whenever we evaluate a new investment, we always first approach it from the standpoint of "What can go wrong and what's our downside risk?" We spend a lot of time analyzing this. Only after we've carefully considered the risk of every investment do we move on to the next step of determining our upside, and this philosophy applies to all of our existing holdings as well that we carefully monitor. Most of the time, to use a baseball analogy, we are trying to hit singles and doubles to advance the runner, and we're not swinging for the home run.

When we're buying a bond, we do everything at our power to make sure that we never own a bond that can default. If we ever get an uncomfortable feeling, which happens from time to time, we are very quick to sell the bond. When we buy a bond fund, we review their holdings to make sure the manager is not getting his returns by going too far out in maturity or by taking big risks with large positions in low-quality bonds. This conservative philosophy also applies to equities and the equity funds we invest in. We tend to be very valuation sensitive. We look for companies and invest in mutual fund managers that also invest in attractively valued businesses based on free cash flow multiples. So we know that we're not overpaying for businesses. In the event the stock market goes the wrong way, we can feel comfortable buying more of these holdings and having a good feeling that we will come back in time and eventually appreciate.

As far as flexibility goes, what we mean by this is that, although we have general parameters for our strategies for equity and fixed income weightings, we do have a lot of leeway to shift into different types of stocks and bonds. We have the ability to increase our weightings, as I mentioned before, into small cap, into large cap, international, and each of those categories can outperform or underperform depending on where we are in the economic cycle. This same idea applies to our bond investments, including the bond funds we invest in. Many people don't realize this, but different bonds, like investment-grade corporates, high-yield corporates or government bonds, outperform or underperform depending on where we are in the economic cycle

1-Year Daily Chart of Yacktman Fund

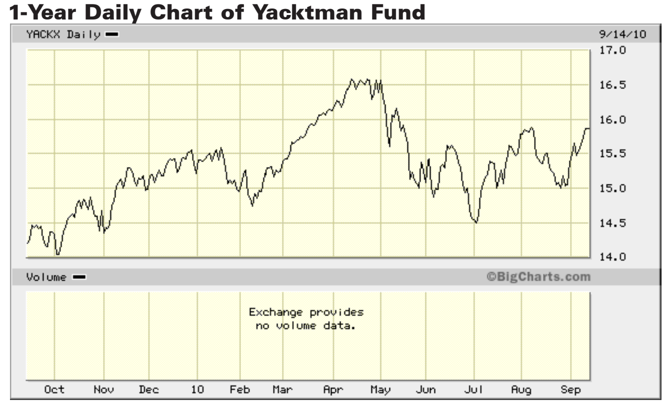

Chart provided by www.BigCharts.com

and which direction interest rates are moving. So we have the flexibility to adjust for the types of bonds and bond funds we are investing in, in our strategies.

TWST: You certainly hit on this, but how does that philosophy and management style give you an edge over your competition?

Mr. Chaitman: I think that a main advantage that we have is because we can adjust our strategies to different bonds and stock categories, we are always to able to focus on the most desirable market segments at a specific point in time. Most managers, as you know, are locked into one particular market segment or a narrowly defined strategy. They may focus only on large-cap stocks, small-cap stocks, global stocks or, in the case of a buying a bond fund, they might be restricted to only government bonds. So because we have flexibility, we can always focus on the best opportunities at a given point of time.

TWST: Your literature also notes that your independence sets the firm apart. How does that independence help investors?

Mr. Chaitman: As a registered investment adviser, we're held to a high standard as a fiduciary. What that means is we are always required to act in our clients' best interest. Since we are independent, we don't have conflicts, so our interests are easily aligned with our clients. We work on management fees, and we never receive commissions. For our high-net-worth and institutional clients, since we are independent, we are able to work from whatever brokerage platform we choose. We chose Fidelity's institutional platform because it's very stable and Fidelity's a profitable firm with an excellent reputation. Their platform gives our clients access to over 10,000 share classes of mutual funds from hundreds of different mutual fund companies. This is important since we're able to buy, to pick and choose the top mutual funds, and Fidelity actually waives the sales charges and commissions on many of the best mutual funds that typically have sales charges if they are purchased through other channels. We're independent, so we don't care what mutual fund company is managing the funds as long as it makes sense for our clients. We own mutual funds that a lot of people have never heard of, like the Yacktman Fund, Osterweis Strategic Income (OSTIX), which is a flexible bond fund, and we own the **Permanent Portfolio** (PRPFX). These are all top funds that achieve different results based on the assets that are in their portfolios, but they make a lot of sense, and we can purchase them for clients because we are independent.

Our independence is also a major advantage for 401(k) clients. Next year there are new fee disclosure rules coming for companies that offer 401(k) plans. In many cases, 401(k) plans have high asset fees that are tucked inside the expense ratios of the proprietary mutual funds being offered by the 401(k) plan provider. As an independent firm, we have the ability to partner with many different 401(k) plan administrators. We prefer to work with companies including Paychex that have true open architecture platforms that are low cost. The fees to our clients are fully disclosed and we have the ability to select the best mutual funds when we create a plan since there are thousands of different funds that the financial advisor can evaluate. So as you can see, being independent has tremendous advantages for our 401(k) service.

TWST: You have the four basic portfolio models and the flexibility to capitalize on different segments. Would you briefly run through each portfolio and give us general sense of where they're positioned today?

Mr. Chaitman: First we'll talk about Strategic Income, which is our bond strategy and the most conservative. Right now that's mainly invested in a portfolio of high-yield corporate bonds. The majority of the bonds we're in are rated BB, and we have bonds that mature between 2010 to early 2015. Our average maturity is probably in the two-and-a-half- to three-year time frame right now. Most of the bonds we've been buying lately have yield to maturities between 4% to 7%, and that compares to the 2.5% rate that you can get on a 10-year treasury bond right now. So that explains why we're positioned this way,

1-Year Daily Chart of Permanent Portfolio

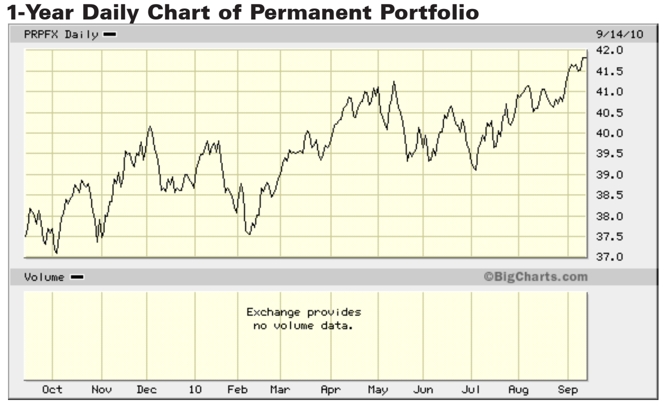

Chart provided by www.BigCharts.com

because we're getting a much higher return and we feel we're investing in very solid credits. We're not particularly concerned about having much default risk on our investments. To give you a few examples of the bonds we own in this strategy, we own **Cablevision**'s (CVC) bonds, we own **Liberty Media** (LINTA), **AES Corporation** (AES) and, as I mentioned, these are all solid credits because they're on the shorter end of the yield curve; we're not taking much interest rate risk. If the economy gets weak, we know these types of businesses are unlikely to default, and if the economy strengthens and interest rates rise, high-yield bonds will outperform many other categories. And since we have these shorter maturities, we'll be able to reinvest at market interest rates when our bonds mature in a few years.

Our Moderately Conservative Strategy is about 30% invested in equities right now and most of the balance is in bonds. This is actually more defensive than we would ordinarily be since we're able to go up to 40% equities. We actually have lower equity exposure in all our strategies right now that contain equities compared to what we would do if the economy were more stable. Our Moderate Strategy is 55% equities, and we could go to 65%, and our Aggressive Strategy is 80% equities right now, and we can go to 100%. In all these strategies, we've been focusing a lot right now on large-cap value stocks that pay dividends, and the mutual fund managers we're investing have similar value approaches. The markets have been in a trading range, so we're collecting an income stream for our clients while we wait for the economy to straighten out.

Our Opportunity Strategy, which is our most aggressive strategy, is 80% invested in stocks. It has another 10% in high-yield bonds and we're also keeping around 10% in cash right now, waiting to take advantage of some of this recent market turmoil. We've been watching many cyclical stocks come under pressure and hope to capitalize on some interesting situations we're monitoring. Some of our larger holdings include **Teva Pharmaceuticals** (TEVA), which is the largest generic drug producer in the world; we own **Wendy's** (WEN), **AT&T** and we own the master limited partnership **Kinder Morgan** (KMP). These are all attractively valued businesses based on high free cash flow multiples.

TWST: You mentioned some of your key holdings in several portfolios. Would you explain some of your best ideas or stories at the moment?

Mr. Chaitman: I think I mentioned that we recently bought **AT&T** for our clients. And we actually bought that stock — this is not typical — but we bought it for all of our strategies except for our dedicated bond strategy. **AT&T** is not exactly an underfollowed situation, but it's a stock that I've owned repeatedly in the past at the different funds where I worked. I know the company well and the valuation makes sense right now. We bought it a few months ago, and it's up nicely. But even at today's valuation, it's attractive. It has a 6% dividend yield, and that's a safe dividend. The company has had over $30 billion in operating cash flow over the last three years, and it has had very stable cash flow. It has a free cash flow yield in excess of 10%, which is unusual. If you consider that a 10-year treasury bond is paying 2.5% right now and you can collect over 6% a year in a safe dividend from a stable company like **AT&T** that's also raised its dividend for 25 consecutive years, it doesn't take too many years to recoup the investment from the dividend alone, not to mention the opportunity for capital appreciation.

We also own **Kinder Morgan** for our strategies. It has a 6.5% distribution, which is similar to a dividend only it's more tax efficient over the short term based on the current tax code for master limited partnerships. **Kinder** is a leading energy and transportation storage company. It has 40,000 pipelines across the country and storage facilities that are used to move oil and natural gas across the country. Even though it's energy related, its business is very predictable and stable. It has stable cash flow that the company has used to consistently raise its distributions over the past decade. They have fixed-price, three- to four-year contracts for their transportation and storage facilities, and that allows them to have very predictable cash flow. MLPs have been a great investment over the past decade. **Kinder** is one of the strongest MLP companies around, and it is well managed, so we think it will continue to be a good investment over the long term.

TWST: With what's happened over the last couple of years, has the tone of the advice or the advice that you give to your clients changed?

Mr. Chaitman: I will tell you that the events that took place in 2008, they have created a new mentality for many investors. People are much more risk averse today than they were several years ago. Today most people are very happy to get a 5% to 10% annual return if they feel they are not taking on too much risk. This is very different than a few years ago. This has been positive for our Strategic Income Bond Strategy. We've had strong asset inflows based in part on our performance, which has been very good, but I also believe it's a function of the conservative mindset that many people have today. Individual bonds are appealing right now since they are predictable — you know in advance the rate of return you get on a bond if you hold it to maturity.

1-Year Daily Chart of Kinder Morgan

Chart provided by www.BigCharts.com

Another thing that people care much more about today than they did before 2008 is having a very stable and transparent brokerage platform where their assets are being held. I mentioned before that we operate from Fidelity's institutional platform; all of our clients can log into their account using the Internet and examine their holdings at any time. Having this transparency and knowing your investments are being held at an independent, secure custodian is a very big deal today, and it should be. When our clients invest, they write a check to Fidelity and their cash is deposited into their Fidelity accounts. We have discretion to make buying and selling decisions, but we never directly handle their funds. I think as far as investing goes, it's very important to pick managers that are on a secure and transparent platform, like Fidelity, Schwab or a TD Ameritrade, and to be able to verify that managers are investing in what they say they are. If you can't get comfortable with this, then you shouldn't invest with a manager.

TWST: There is so much uncertainty right now about the future of the economy and the markets. What advice on how to deal with volatility and uncertainty would you offer?

Mr. Chaitman: First of all, this is not something that's going to go away. Every year the financial market seems to move faster and faster, and I think a lot of this is due to the automation in the industry. There is a lot of black box trading, proprietary trading systems out there that are influencing the daily volatility in the financial markets, and that's not going away. I would say the most important advice I can think of for individual investors to consider is that they should make sure that they're in the right asset allocation, an asset allocation that works for them. If you're in a right allocation and you know why you're in it, then it's much easier to handle daily volatility and you have a tendency to think longer term, which is the right way to invest, and not get distracted by the short-term events and fluctuations in the markets.

TWST: What are the two or three best reasons for a long-term investor to look closely at Shelter Rock Management?

Mr. Chaitman: We add a lot of value for our clients. We've had excellent risk-adjusted returns in our strategies, and we provide a lot of personalized service for our clients. I have had a lot of unique and differentiated investment experiences compared to other advisers and managers, and I would say that this is especially relevant in today's markets. I believe this experience will help us continue to deliver top returns for our clients. Since we started Shelter Rock, we've had a 95% client retention ratio, and not a lot of others in the industry can say this. I think that number speaks for itself. What it means is that our clients are comfortable having us manage their investments, and I feel that this will continue to be the case for future clients that hire us to manage their investments.

"I have had a lot of unique and differentiated investment experiences compared to other advisers and managers, and I would say that this is especially relevant in today's markets."

TWST: Thank you. (MJW)

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