Strong Investment
Management

Strong's Investment Selection Process

Strong Investments uses a multitude of indicators to determine sector allocations. These indicators are a part of the top-down portion of our investment process and provide the basis for establishing relative risk and return expectations for each sector. These indicators include:

- Economic drivers such as monetary policy, yield curve, and relative GDP growth analysis.
- Political drivers such as taxation, governmental stability, and political turnover.
- Sentiment drivers that primarily measure consensus thinking to identify the relative popularity of investment categories. The interpretation of such sentiment drivers is typically counter-intuitive (avoid what is overly popular and seek what is largely unpopular).

Often times, these decisions are predicated on exclusionary management. This involves determining what categories to avoid or underweight based on relative expected risk, and therefore over-weighting the remaining categories that should have the highest relative expected return. The Strong Advisory Board, with the assistance of the firm's research staff, continuously monitors these drivers to ascertain if any of them are indicating an extreme reading, and if so, whether the market has discounted the factors yet. Only material readings not believed to be fully discounted into pricing are acted upon. The Board uses this information to determine sector weightings relative to the benchmark.

Strong's Investment Process: Securities Selection

Once portfolio weightings are determined, a series of risk factor screens based on desired style characteristics are applied to each category requiring a weighting. Securities passing these screens are then subjected to further quantitative analysis to eliminate companies with excessive risk profiles relative to their peer group, companies with excessive leverage or balance sheet risk, and securities lacking sufficient liquidity for investment. We apply fundamental research to ascertain which stocks within a given category would accomplish two goals:

First, Strong seeks companies possessing strategic attributes consistent with higher level themes in the portfolio derived from the drivers mentioned earlier. For example, if we believe owning companies with dominant market share in consolidating industries is a favorable characteristic; we search for companies with that profile within the particular category we are examining.

Second, Strong seeks to maximize the likelihood of beating the category of stocks from which we are selecting. For example, if we determine we want a particular weighting in the portfolio of large cap technology companies, and need four stocks out of 17 that meet the quantitative criteria, we then pick the four that as a group maximizes the likelihood of beating all 17 as a whole. This is different than trying to pick "the best" four. By avoiding stocks likely to be extreme outliers versus the group, we believe we can reduce portfolio risk while adding value at the security selection level.

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Based on this analysis, the Board selects securities for purchase. Additionally, the Board applies risk management controls based, among other things, on an analysis of prospective stocks to assess their correlation to the sector in order to maximize the possibility of leveraging top level themes and to identify unintended risk concentrations in the security selection process. Performance is regularly decomposed into sector and stock factors to confirm that alpha is derived from intended sources.

We often build investment positions incrementally; keeping an eye on corporate earnings, news events, and other business developments to confirm our initial investment commitment. Similarly, we also divest in stages as price targets are realized, or when adverse developments reduce our estimates for price appreciation. We believe this painstaking approach reduces risk and improves investment results.

We attempt to mitigate risk by selecting established, quality companies available at valuations we believe are attractive. We continuously monitor our investment positions to detect any fundamental or technical changes, and take decisive action as we work to protect principal. During extended periods of expected market weakness, we strive to hold substantial cash or cash-equivalent positions; and when conditions dictate, we have invested in no-load, short-term bond mutual funds to maximize returns for medium-term market volatility. This is true even in our Equity accounts, which typically are invested solely in stocks.