

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

An Alternative Approach to Income Investing



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Risk, Enhancing Portfolio Returns," "Managing Portfolios For Optimal Tax-Efficiency" and "Convertible Securities as an Asset Class." He is an internationally published market commentator and is frequently quoted in the securities news media, including The Wall Street Journal and Barron's.

NICHOLAS A. CARUSO JR. is Senior Vice President and Chief Wealth Strategist of Wolverine Investments, where his duties range from portfolio management and research to new business development. As a strategist, he designs and monitors customized technical indicators to measure market momentum and investor psychology. Prior to joining Wolverine Investments in 2005, he spent the majority of his investment career with Merrill Lynch & Co., Inc., where he was a Vice President of the Private Client Group. Over his long career, Mr. Caruso utilized both proprietary technical and fundamental investment strategies to reduce exposure to risk while enhancing growth of principal opportunities. He maintains that providing clients with portfolio protection and income enhancement is the most common sense approach to producing more consistent portfolio returns. After graduating from Sacred Heart University with a Bachelor of Arts degree in Business, he attended Bridgeport University where he earned a Master of Business Administration degree. He also served in the Military Intelligence division of the U.S. Army during the Vietnam War.

TWST: Would you start by bringing us up to date on Wolverine Investments?

Mr. Babyak: We've gone through a number of high-level organizational changes since the last time we spoke, which I believe was back in September 2005. At that time, as you may recall, we were right in the aftermath of the passing of our founder and long-

time CEO, Warren Bree, who had died that August. Our firm has been through more than a few changes the past two years. For starters, we took advantage of a rare opportunity to streamline our name, so as opposed to the lengthy incorporated name of WHB/Wolverine Asset Management, Inc., we're now simply known as Wolverine Investments. As a matter of fact, we applied for and were subse-

quently granted registered trademark status for the name Wolverine Investments. During the past year, we've re-tooled and re-launched our Website, www.wolverineinvest.com, to better communicate our strategies, as well as what our firm stands for, and to further distinguish ourselves from other conventional money managers.

But by far the most significant change I can report on is just this past October we concluded a lengthy negotiation and buyout process for change in control and a new ownership structure for the company. Therefore, I'm pleased to announce that at this moment, I am the proud owner of 94% of the outstanding shares in Wolverine, with our employees, officers and Directors making up the balance of ownership in the company. These changes should leave no doubt as to the strategic direction of Wolverine, as it is my fervent hope and ardent dream to build upon our past successes and to continue to serve our clients with a timely and well-executed vision for decades to come.

Babyak: Over the past six years, as we've transitioned from a pure retail money management firm, we're now ideally positioned to fill a subadvisory role in working with wealth managers, financial advisors, planners, private banks, etc. Our flagship product, Yield-Enhanced Convertibles, is geared specifically to this institutional audience, but we also offer institutions a High-Yield Convertible strategy to complement our Balanced Asset offering for individual investors.

TWST: I'm sure Wolverine will be steered in a very good direction.

Mr. Babyak: We believe wholeheartedly that will be the case. Since the time our investment management firm was founded nearly 20 years ago by Warren H. Bree, we have prided ourselves on financial soundness and stability, longevity of our business, and loyalty to our founding investment principles. We no doubt became a younger company overnight, but the average length of time our investment professionals have been in the securities industry still exceeds 25 years. So we bring a lot to the table in terms of experience, not to mention a lot of great ideas, with the quality personnel we have in place currently.

We're still fiercely focused on our longstanding core competencies of convertible securities and covered option writing, which have been hallmarks of Wolverine since inception of the firm in 1988. We've always portrayed our style as being well suited to investors seeking a balanced approach to the financial markets, but I think we will especially appeal to those investors who recognize that strict attention must be paid to asset protection and the management of

risk. Our underlying fundamental philosophy will always be that wealth is best created by long-term ownership in growing businesses. Complementing our occasional direct investment in common stocks, we will continue to concentrate our investment direction in convertible instruments, together with our unique overlay of covered call options. We will always relish playing the role of banker for our clients, as opposed to simply speculating in common stocks.

TWST: Tell us about the strategies that have made your firm so well known.

Mr. Babyak: As I mentioned, we maintain two core strategies in convertible securities as well as the covered option writing on both convertibles and common stocks. These competencies are configured into various yield-enhanced strategies that together produce very strong risk-adjusted returns, which is exactly what our target investor audience is seeking. As our historical track record clearly illustrates, we deliver stock market type returns, with volatility more closely correlated to classic fixed-income benchmarks. We don't view our mission as an attempt to outperform the major stock market indices, but to perform commensurately with a balanced mix of stocks and bonds, with much greater alpha, or relative outperformance. So we believe there is a very compelling value proposition to be evaluated with our key strategy.

Over the past six years, as we've transitioned from a pure retail money management firm, we're now ideally positioned to fill a subadvisory role in working with wealth managers, financial advisors, planners, private banks, etc. Our flagship product, Yield-Enhanced Convertibles, is geared specifically to this institutional audience, but we also offer institutions a High-Yield Convertible strategy to complement our Balanced Asset offering for individual investors.

TWST: What is the investment climate like for your type of investment strategies right now? Give us an outlook for 2008 since we're now closing in on year-end.

Mr. Babyak: The tack we take is we don't try to make money in one single fashion. Our overall approach is to take advantage of market conditions to generate a total return for our clients which is comprised of one or more of three distinct areas. The first area is capital appreciation. If the underlying equity markets are so positioned, our convertible and common stock positions will appreciate in accordance with the market, but the key differentiating point to bear in mind with our style is we're simultaneously invested in higher-yielding, dividend-producing convertible instruments, and these definitely impart a fixed income quality to all of our portfolios. In general, our average current yield across our composite of client accounts is between 4% and 4.5%, which by itself is not too shabby a return, especially given the subdued environment for common equities during the past 12 months or so.

Finally, and probably most important, there is a third component that drives our total return objective, and I'd like to focus on it for a moment. We uniquely capitalize on the volatility in the common stocks

underlying our individual convertible and common stock holdings by capturing premium from covered call options. The net option premium — something we call option “yield” — flows from volatility directly to the bottom line in our total return approach to capital appreciation.

For several years, through the end of 2006, market volatility was rather restrained. Then, beginning in February of this year, with the emergent trouble in the Chinese markets as well as other global regions, the minor market correction that followed provided some foreshadowing of the dramatic increase in volatility that would become much more evident later in this calendar year. We all know what happened over the summer beginning with the earthquake in the credit markets, and the mortgage and housing industry. The stock market proceeded to experience two separate 10% corrections in the space of five months. Additional tremors have reverberated through every area of the financial markets, and this has propelled the volatility index to levels we haven’t seen in at least five years. But volatility is actually helpful to our strategy on both a relative and absolute basis, and has been responsible for driving half of our total return performance year to date.

We think we’re well positioned to take advantage of continued volatility in several different ways. First, the underlying convertible securities that we own for clients have an inherent optionality because convertibles usually give the holder the option of converting to common stock at some point. As a result, we have seen an increase in the optionality, or the embedded option value, within the structure of most of our convertibles. Consequently, higher volatility has increased the value of our convertibles compared with their underlying common stocks. In addition, when we sell call options on both convertibles and common stocks, the increased volatility enables us to generate more net option premiums on the short call positions overlying our long core convertible holdings. The current environment has made a very attractive case for our unique style of investing, so we’re obviously very positive about the future. We think that volatility is here to stay for a while, and as anyone who follows the financial markets regularly can attest, higher volatility can be a real headache or a curse as well as a positive. We are of the opinion that investors should take better advantage of the current market environment, by turning a would-be negative factor into a real positive contribution to portfolio performance.

TWST: Your research process is more theme-driven rather than top-down or bottom-up, it seems. Would you take us through your investment decision-making process?

Mr. Babyak: We do like to characterize our overall investment decision-making process as theme-driven. We combine both the top-down understanding of what’s happening with the economy, with a bottom-up analysis of individual companies. This has served us well throughout our firm’s entire history. We like to remain focused on long-term trends in the market, whether they are growth-oriented or cyclical in structure. Over a period of time you won’t see much change in our themes.

However, we have seen a definite inflection point over the past few years which I would like to touch upon. Traditionally, we’ve been very heavily weighted toward the financial industry and financial stocks, specifically banks, as this theme was built on the premise that a huge intergenerational transfer of wealth was just beginning to take place. We’re still only in the fourth or fifth inning of this giant theme, which is also driving consolidation throughout the financial services industry. Many of our largest holdings in the past were comprised of bank stocks of all varieties, but I’m pleased to report that we’re at our lowest allocation to bank stocks in the 20-year history of our firm.

While we haven’t completely abandoned the financial theme, our exposure to the financial sector has been limited to just a small handful of diversified companies, primarily concentrated in the insurance industry. While our exposure to financial companies has declined substantially during the past two years, the direct thematic beneficiary we’ve been building upon is in the area of global growth, specifically an infrastructure development theme. I’m sure we’ll get to some specific stock names later on. I’d be remiss, however, if I didn’t mention that we continue with our commitment to the healthcare theme, since we feel the underlying demographic influences are very much in play. It’s been a profitable area of investment, relative to the aging of both America and the world at large. Finally, we continue to feel that information technology remains a major trend. Our thesis that human productivity continues to be enhanced through technological innovation is something we remain focused on, and we continue to make investments in this area as well. That’s just a kind of high-level overview of our themes at the moment. They really haven’t changed. There has been maybe some reallocation from one to another, but those global themes still continue to hold for us today.

TWST: I believe you were also interested in power as well as energy. Are you still interested in power?

Mr. Babyak: Our interest in power has matured, and the theme has now evolved into a greater investment in the global growth story. Consequently, while we still own a couple of high-yielding power and utility holdings, power is definitely secondary compared to our interest in direct infrastructure and energy names.

TWST: What about credit quality at this time? Are you still finding higher quality?

Mr. Babyak: We’re still able to do what we do best, and we’ve generally maintained the quality of holdings throughout our portfolio. Although I must say, with the meltdown that was initiated over the summer, there has come a major shift in both the perception and reality of the creditworthiness of nearly all companies short of a AAA S&P rating. We’ve seen the housing and subprime mortgage crisis send tremors through just about every industry. Credit spreads, reflecting a rejiggering in credit risk, have widened substantially. We’ve seen a number of our holdings at the lower end of the credit scale readjust and come down in price to reflect the new credit environment. We do maintain an average credit quality across all of our

holdings of BBB, which, granted, is on the low end of investment grade, but it's still very decent quality. The ratings on our convertible bonds and convertible preferred securities range anywhere from B+ up to AA, but the entire rejiggering process, caused by a market-wide repricing of risk, has permeated all areas of the financial markets, and we have not been completely immune to this.

Babiyak: A clever way of summarizing our major theme is we're looking into companies that do one or more of the following: design it, build it, green it, clean it, or protect it. By that I mean we're interested in companies that are designing and engineering solutions, enabling global growth by and rectifying common problems, whether it is in the energy area or in infrastructure.

TWST: You evaluate and identify quality management teams. How important is that to you and how do you look out for managements that identify with shareholders?

Mr. Babiyak: Quality of management is absolutely essential to how we choose investments, even more so than what type of industry or sector a company is in. Clearly, as we've discussed, we're theme-driven, combining both top-down and bottom-up inputs into our fundamental analysis. Before we invest in any single company, however, we've got to be confident that the management team, together with the major stakeholders, are sincere and trustworthy in terms of protecting and enhancing shareholder value. We like to meet with company management whenever possible at conferences or in one-on-one meetings, and we also familiarize ourselves with the mindset of suppliers, customers and vendors. As a small firm, we can't possibly do the same kind of detailed, bottom-up analysis that a much larger firm can perform, so we have to rely on all manner of research inputs — both independent and Street research, to support our own thematic and fundamental analysis. The key is we've got to understand and we must have a strong sense that management believes in what they're doing, that they are competent and committed, and that they have shareholder value foremost in their collective mind.

TWST: Tell us about some of the investments that you have made that you feel are representative of your investment strategies.

Mr. Babiyak: We were just talking about this the other day in one of our Investment Committee meetings. A clever way of summarizing our major theme is we're looking into companies that do one or more of the following: design it, build it, green it, clean it or protect it. By that I mean we're interested in companies that are designing and engineering solutions, enabling global growth by and

rectifying common problems, whether it is in the energy area or in infrastructure. Then there are the companies building up infrastructure, followed by companies involved in creating a safe and clean environment. Finally, we have heavy investments in companies that insure and protect assets, like diversified insurance companies.

About two years ago, we began a concerted effort to become more heavily invested in stocks like **Fluor (FLR)**, **Jacobs Engineering Group (JEC)**, **Chicago Bridge and Iron NV (CBI)**, **Foster Wheeler (FWLT)**, **Halliburton (HAL)**, **Oil States International (OIS)**, and an innovative international company named **ARCADIS NV**, which trades on both the Euronext and Amsterdam exchanges.

TWST: Are you now looking at international stocks? Is this a new thing for you or is this something you've always done?

Mr. Babiyak: While we have always analyzed investments by incorporating a global rationale, we rarely made direct investments in overseas companies due to the lack of transparency. So I would say it's a trend that will probably continue, albeit strictly on a very selective basis. We're only interested in considering stocks that are traded on major exchanges and where there is strong liquidity. In the case of **ARCADIS**, it is a Netherlands-based company and former NASDAQ listed security, but since last May has been listed only on the Euronext and Amsterdam stock exchanges, where it trades in euros. So yes, our clients should expect to see more international investments in their portfolios, but not on a widespread basis. Any international investments will be made consistent with our theme-driven philosophy, and will be targeted to areas we already know very well and in companies we can learn about relatively easily.

In full disclosure, I need to tell you that my sister currently works for a US subsidiary of **ARCADIS**. And while I certainly am not privy to any inside information whatsoever, my sister is a mid-level manager from whom I have learned quite a bit about the company's prospects after she asked me to analyze the stock at the time she became eligible for their stock option program. After **ARCADIS** made the move to the Euronext, we didn't hesitate to continue to track and follow the company, as well as add to our current holdings.

For those readers who have never heard of **ARCADIS**, let me start by describing it as an international consultancy, design and engineering company that addresses problems in both the manmade world as well the natural environment. Gross revenues in their recent third quarter rose 31%, while their net income increased 33%. All of their profit centers have contributed to growth, with environmental consulting as the strongest. Geographically, organic growth is best in the US, but the Netherlands and Brazil are also top contributors. **ARCADIS** is also a busy acquirer, having just completed the buyout of US-based **RTKL**, a global player in architectural design and planning services. In the Netherlands, **ARCADIS** just purchased **Alkyon** to strengthen their position in climate change management and to address the growing market for water quality management.

In all the countries where **ARCADIS** is active, there is an urgent need to improve upon and expand infrastructure. Many multinational customers want global service providers, and as a result, **ARCADIS'** market share within the environmental space can increase substantially in the years ahead. There are other international companies that we have invested in, primarily through ADRs.

TWST: Please continue with your infrastructure theme.

Mr. Babyak: Another example is **Chicago Bridge & Iron**, which is also a Netherlands-based company, but the stock is traded as an ADR on the New York Stock Exchange. **Chicago Bridge & Iron** operates as an engineering and construction company in global markets. Its particular expertise is in conceptual infrastructure design, engineering, procurement, fabrication, field erection, mechanical installation, and commissioning services. Some current projects include hydrocarbon processing, LNG terminals, offshore structures, bulk liquid terminals and water treatment facilities. Growth is being driven by expanding share in new LNG facilities, expansion of import terminals, and enhancing refining capacity to enable the processing of heavier and the more sour grades of crude oil.

Another example of an “international” company that is based right here in our own backyard (White Plains, New York) is one of our largest new holdings — the farm-to-consumer company, **Bunge Limited** (BG). At one time this was a Belgian company and they later moved their headquarters to Argentina. **Bunge** is a New York Stock Exchange-listed security, but the company very much has a global presence in the emerging markets. They have a strong foothold in the world’s largest food production regions, and they are focused on expanding in the fastest growing consumption markets. As I said, **Bunge** operates along the farm-to-consumer food chain, selling everything from raw materials, such as grain and fertilizer, to retail products such as margarine and mayonnaise. By the way, **Bunge** is also the world’s largest oilseed producer, the largest producer and supplier of fertilizer to farmers in emerging markets, and a leading supplier of bottled vegetable oils worldwide.

TWST: There are a lot of convertible securities in the healthcare area and you’re well represented in the sector. What have you found interesting?

Mr. Babyak: We continue to like health care as a defensive type of sector; as long as the yields are there in convertible instruments, we’re going to continue to maintain a presence. We have a major position in two global franchises, **Wyeth** (WYE) and **Schering-Plough** (SGP); the two continue to be among our largest holdings.

We’ve also recently added an investment in **Thermo Fisher Scientific** (TMO), which is the result about a year ago of the merger between Thermo Electron and Fisher Scientific. What we like about this reallocation to a new name within the healthcare theme is that **Thermo** is not a direct play on the pipeline quality of any one company. This means we are sacrificing big upside potential for more consistent earnings growth. **Thermo** is a leading manufacturer and developer of the analytical and laboratory instruments, as well as sup-

plies, for the entire biotech industry, with a hand in life sciences, drug discovery and industrial applications. Not being as close to the drug development pipeline has several advantages in that we are somewhat isolated from the risks inherent in the FDA approval process. The analogy is similar to avoiding direct investment in other pure “pipeline” plays such as within the Oil Patch, as with **Exxon** (XOM). We much prefer the oil servicing companies like **Halliburton** and **Oil States International**, which again is analogous to our investment in **Thermo Fisher**, also a servicing company within a different industry.

TWST: You mentioned that you are still invested in the financial services area, not in the banks, but in insurance. What do you like there?

Mr. Babyak: We continue to own **Hartford Financial Services** (HIG), which I believe was our largest holding the last time we spoke, but we have somewhat reduced our investment in that name in recent months. One of our top holdings remains **MetLife** (MET), which we added to the portfolio about two years ago. Their growth has slowed somewhat in recent quarters, but we believe that the company is poised to continue to benefit from a diverse business mix; strong organic growth; impressive, trustworthy management, that we confidently believe will deliver on what they say. The whole demographic of what we spoke about earlier, the intergenerational transfer of wealth, will benefit this company in terms of retirement in the savings segment. **MetLife** is a name that we believe should be a core holding as a diversified US life insurance and financial services company.

TWST: You focus on higher quality companies, but are there any contrarian bets that are of lower quality that you include?

Mr. Babyak: One company where we have gradually lost faith in the company’s management, but where there is a distinct turnaround possibility, is **Omnicare** (OCR). This company services nursing homes and other health providers within the pharmaceutical marketplace. **Omnicare** performs as a drug distributor, but they’ve had a lot of difficulty adapting to the new realities in Medicare and as technology has changed. They integrated NeighborCare two years ago, and management has been a bit slow to adopt new technology. We were on a conference call with management months ago and we learned that their salesmen are still faxing in orders to the home office and we were a little taken aback by that. Thinking as a contrarian, we could surmise that if that’s the way they’re doing business, there is nothing but upside. Admittedly, the company has suffered, and its stock price is down significantly from its highs a couple of years ago, but it might just be a turnaround situation.

Actually, the more likely scenario is that **Omnicare** is a perfect opportunity for a private equity or some other deep-pocketed company to come in and transform, since the business has a terrific franchise and maintains the highest market share in an area that is not going to disappear. The demographics will tell you that as the aging in this country continues and more people move into assisted living and nursing homes and so forth, this is a phenomenal opportunity.

A company that is quite controversial at present is **E*TRADE Financial** (ETFC) and we do have a small position we recently initiated in the convertible preferred of this company. We all know them from their clever commercials on television, and as a discount broker competing with the likes of **TD Ameritrade** (AMTD) and **Charles Schwab** (SCHW). **E*TRADE** did get themselves into some trouble during the last two to three years by investing in the mortgage industry. This came about because of the so-called synergies within their banking and brokerage clients. **E*TRADE** figured they knew their discount brokerage customers and stock traders well enough, and they could simply turn around and start making second lien mortgages and issuing home equity lines to account holders. That would have been fine up to a point, but then they started packaging these loans and outsourcing the collection of them so that they eventually lost touch with their consumers.

Do we think the company is going to remain in business? That certainly is a question mark, and of course if you don't believe they're going to survive, you should not go near the stock. But with the stock trading where it is currently, it might be analogous to buying a long-term call option. We have seen a major infusion of capital into the company by a very large Chicago hedge fund called Citadel and they have done their homework. I've done extensive analysis on the kind of work that Citadel has done. They have sent in teams of people to review the **E*TRADE** database and all their financial reports and statements, and they have come away convinced that the company can still make it. It is an investment opportunity not for the faint of heart.

TWST: The other sector that has been battered by that earthquake you mentioned is the consumer sector. Is that of any interest at this time?

Mr. Babyak: Actually, we are very much intentionally underweighted in this sector, having exited over the past two years from such names as Toys 'R' Us, **J.C. Penney** (JCP) and, most recently, **Best Buy** (BBY). However, I'd like to take this opportunity to introduce our Chief Market Strategist, Nicholas Caruso, who's been keen on a different, but interesting, retail name. Nick joined Wolverine Investments about two and a half years ago and provides input to our research process, and serves as a member of our Investment Committee.

Mr. Caruso: I'm happy to spend a moment discussing the current opportunity that exists with **Saks** (SKS). This high-end retailer needs no introduction to the upper middle class consumer, especially with well-heeled (no pun intended) female shoppers. **Saks** should, in my opinion, be of interest to investors for several compelling reasons. Very recently, the company announced their same-store sales for November, which surged an impressive 25%. **Saks** also settled its lawsuits that alleged abusive practices against vendors. This cost the company \$2.7 million in aftertax expenses, but the important fact is the lawsuit has been settled, and **Saks** can move forward again.

Over the past year, **Saks** has been closing its least profitable stores, but has also been expanding; it has opened a large store in Mexico City. Obviously, this time of year is important to retailers, and I realize that the current credit and liquidity crisis pervades our entire economy. But most consumers who shop at **Saks** are not in jeopardy of losing their home, so their sales should be just fine. **Saks** remains a world-class operation, whose name is recognizable, even in Iceland. On October 31 of this year, Baugur Group, an Icelandic investment firm, announced they were owners of 8.5% of **Saks'** common stock, and they also announced that they were considering further acquisition proposals. Baugur currently owns British retailer House of Fraser and Hamleys, and they have stakes in various other retailers around the globe. Baugur also said it may make a joint proposal with Dubai-based Landmark Group, an investment firm that currently has a 1.2% stake in **Saks**.

Moreover, on December 4, Icelandic holding company FL Group signed an agreement to buy the property assets of Baugur Group in an all-stock deal worth 53.8 billion Icelandic crowns, or US\$873 million. Baugur said that their property sale will give them more focus on their retailing assets. I see a crown jewel American retailer on the radar screen of a large global investment firm, fueled by the interest of a petrodollar, sovereign wealth nation. It's difficult to assess the final deal price for **Saks**, but whatever the price, Baugur has more than enough resources to pay up for their first entree into the fabric of a premier American retailer.

TWST: What about technology? You haven't mentioned any technology companies.

Mr. Babyak: We're most interested in the technological innovations of this era in history, but our presence would best be characterized as targeted, by typically investing in larger cap, familiar companies. Our thesis is based on the idea that human productivity continues to be enhanced through innovation. For years, we have been a holder of **IBM** (IBM) and we continue to maintain a long-term perspective on the company. About a year and a half ago, we began to add some money to the tech sector, primarily in the larger cap names.

Our largest holding in the tech space right now is **Intel** (INTC), a familiar household name, and the world's largest manufacturer of microprocessors, etc. They were a victim of a real and damaging price war that ensued between themselves and **Advanced Micro Devices** (AMD). **Advanced Micro** gained an advantage by attracting customers for its very efficient and speedy chips between 2005 and 2006, whereby they gained about 10% market share on **Intel**. After losing market share, **Intel** fought back through a series of strategic maneuvers, and as a result, their new line of microprocessors is both faster and more power efficient, so we think that they've turned the corner. The stock has been on the move in recent months, and we have investments in both the common stock and in the convertible bonds. There has been some margin pressure because of the tough competitive environment with **AMD** and others, but profits continue to look promising there. We're expecting 20% improvement

next year over this year's EPS. While top-line revenue decreased last year, it's rebounding this year and we see sales in 2008 about twice the growth rate that we saw in 2007. Even after factoring in a p/e of just 20 to 21, you can come up with an estimated valuation of at least \$30 a share, which represents a 15% return from where the stock is trading today. Typical of a good, solid core investment, we much prefer to play technology in a general way, and not try to bet on individual gadgets or what's the hottest product right now. Clearly, a lot of investors have done well with various gadget companies — **Apple** (AAPL) comes immediately to mind — but we think that a mainstay like **Intel**, or even a **Microsoft** (MSFT) or a **Corning** (GLW) is a much safer way to participate in the tech sector.

Caruso: Our Yield-Enhanced Convertible strategy automatically reduces risks, and second, the strategy certainly increases cash flow from the writing or selling of the covered call options. Together with the coupon, history dictates that our firm's holdings over the past several years have averaged coupon parameters of at least 4%, and the selling of the options on the convertibles, which is a surrogate for the underlying stock, adds another 4% per annum.

Mr. Caruso: If I may, I'd like to spend a minute discussing a very interesting software developer named **i2 Technologies** (ITWO), which has created an innovative approach to inventory management. Its system enables companies to proactively manage their supply chain risk with real-time, decision support information. Recently, **i2** announced an agreement with **HCL Technologies**, one of India's leading IT services companies, to allow **i2** to deliver on its goal of bringing the power of **i2 Business Content Library** to a worldwide market. This development, coupled with **i2's** deep supply chain management domain expertise and market-leading products, will create innovative solutions for companies needing help with supply chain management.

This past September, the investment firm Amalgamated Gadget announced they owned a 17.6% stake in **i2** via ownership of **i2's** Series B convertible preferred stock. Furthermore, in October, SAC Capital, the large and renowned hedge fund, disclosed in a 13-D filing with the SEC that it had increased its stake in **i2** from 1.1 million shares to 1.9 million shares, or 8.9% of the company. SAC Capital said it believed the stock to be undervalued and that the best way for **i2** to increase shareholder value would be a public sale of the company. One Wall Street analyst believes **i2** could be worth as much as \$22 a share in an acquisition.

Finally, **i2** itself announced the recent formation of a strategic review committee, made up of independent company Directors,

to consider options for enhancing shareholder value, including possible sale of the company. JPMorgan Chase has been retained by **i2** to review all proposals and is supposed to report back to the **i2** Board of Directors no later than January 31, 2008. I believe **i2** will be sold at a handsome premium compared to the current price of the stock.

TWST: Would you explain your approach to risk management? What triggers an exit from your portfolio?

Mr. Babyak: It depends on what kind of a holding it is. If it's a convertible, there may be violations to our convertible parameters that cause a sell signal to be exhibited. The lifecycle of a typical holding in our portfolio is two to three years and the convertible path as long as the fundamentals are sound with the underlying stock is a win-win situation because worst case, the convertible goes out at par, assuming we bought it near par. We don't lose any money, we pick up a little bit of cash flow and there is no harm. That's why we do tend to stay away from high priced or low premium convertibles. In the best-case scenario, we just convert the stock and continue to own the common stock for some period of time before we exit.

As far as an outright sell, clearly a change in the company's fundamental business is the key thing we watch for. If there is a material change or change in management or some major blow to the company, that's going to cause us to rethink; if there is a technical price breakdown, we've got to take that into consideration. For example, if the markets were to pull back 10% and our stock came back 8%, this would be relative outperformance that would not trigger a sell signal. Conversely, if the market were to fall by 10%, and our stock were to be down 15% or more, assuming a market beta, we'd have to take a hard look at the holding and evaluate if there is a fundamental change at work. In that case, we might very well begin the process to exit and liquidate the security position.

TWST: What gives Wolverine Investments its edge? What are the defining features that you think makes it distinctive compared with other firms?

Mr. Caruso: I think the strategy itself is a great one. First, our Yield-Enhanced Convertible strategy automatically reduces risks, and second, the strategy certainly increases cash flow from the writing or selling of the covered call options. Together with the coupon, history dictates that our firm's holdings over the past several years have averaged coupon parameters of at least 4%, and the selling of the options on the convertibles, which is a surrogate for the underlying stock, adds another 4% per annum. One of the keys is that certainly we're providing to investors an 8% cash flow on average and that's important. Secondly, we're doing so with very low volatility. I guess one of the benchmarks is when you look at an S&P, which has a standard deviation of about 16, our standard deviation is basically 4 to 5. Here you have the best of both worlds. From a standard deviation point of view, we're much, much closer to a bond's standard deviation; but on a total return basis, we're much closer to an

equity driven portfolio. The combination of low volatility and market-like returns is something that we think investors would be looking obviously to hire.

TWST: Who are the typical clients of Wolverine Investments?

Mr. Caruso: They run the gamut. We'll start with high net worth individuals, some of whom are in their golden years. With interest rates being where they are, many of these investors have lived through other periods of time when CDs and Treasuries, or other types of fixed return instruments paid them much higher returns. They now should be looking to us to provide income that they can even withdraw for their life style. We also interface with other money managers of much larger size. For example, our largest account is a firm in New Jersey where their minimum account is \$3 million and they manage nearly \$2 billion. They in turn do a variety of functions like taxation, estate planning, financial planning and the sort, but what they do is they carve out for themselves an asset allocation model and fortunately Wolverine has that piece of the pie that says convertibles on it. We in turn are hired by them to invest those funds that are set forth for the express purpose of convertibles for their clients.

Mr. Babyak: Currently, that's between a 6% and 9% allocation of their total portfolio. It is a small piece of a very large pie and it is basically what we're looking to do. We have positioned ourselves now as a subadvisor to wealth managers, investment advisors, financial planners, private banks and so forth.

TWST: That's a great decision on your part because I talk to a lot of wealth management services companies and financial planners, and if you can manage that convertible part of the portfolios, it's a good line of business.

Mr. Caruso: It's a great line of business, but convertibles, as part of an asset allocation model, will likely show up the least. Unfortunately, even financial planners and wealth managers unintentionally overlook convertibles as they separate fixed income from equities. They may have municipals in their model, and they probably have corporate bonds and governments. But what's absent in most allocations are hybrids, like convertibles. Convertibles will bolster a portfolio and fill in the allocation cracks. The problem lies in the difficulty of how to properly categorize convertibles — do they belong on the fixed income side of the model or do they belong on the equity side. It requires a little bit of thought. More times than not, convertibles become the asset class that's most overlooked in institutional asset allocations. We have advocated for years that convertibles belong in their own asset class, since these instruments de-

liver real alpha to a fixed income portfolio as a compelling complement or surrogate allocation.

TWST: Is there anything you'd like to add?

Mr. Babyak: I think we've covered a lot of ground today. I would just simply say that the strategies that Wolverine offers are flexible and adaptable across virtually any trading or custodial platform. Our strategies provide exposure to a couple of different asset classes, and as Nick said, we should be viewed as a hybrid, or an alternative investment style even though our accounts are separately managed. Going forward, I think investors need to pay close attention to the ways a risk-adjusted return can be earned in the markets, whether it's through stock appreciation, income producing strategies, yield enhancement, volatility, etc. The outdated classification system of thinking of "asset classes" and traditional "styles" is currently being re-evaluated and re-engineered. We are a firm at the very forefront of strategic and tactical asset management. Investors need to think about blurring the lines between traditional asset classes, and instead look at strategies that offer appeal because they're uncorrelated or because they meet a specific requirement of the investor. Investors, both individual and institutional, should avail themselves of the unique advantages afforded by risk management approaches, whether it's through covered call writing, convertible securities or any other alternative investment vehicles.

Should your readers have an interest in uncorrelated strategies that blur the lines between traditional asset class investing, we would certainly appreciate and welcome the opportunity to explain the advantages of convertibles, covered call writing and other high-yielding investment strategies.

TWST: Thank you.

Note: Opinions and recommendations are as of 12/19/07.

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