

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Investing in Tactical Opportunities



JOHN M. BABYAK is the President and Senior Portfolio Manager of Wolverine Investments, where his duties span all functional areas, including: portfolio management and research; business planning and budgeting; trading, information systems and administration; and new business development and client service. Prior to joining WHB/Wolverine Asset Management in 1993, Mr. Babyak held various systems engineering, sales and marketing management positions at IBM. He graduated from The University of Vermont in 1982 with a degree in Management Engineering. Mr. Babyak has written numerous articles about the markets, including the studies "Rationale for Yield-Enhanced Convertible Securities," "Covered Call Writing: Managing 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 please tell us about your responsibilities at Wolverine Investments and bring us up to date on your firm?

Mr. Babyak: Despite these very difficult markets, our professional investment team is essentially unchanged, and we remain very well positioned to serve our clients going forward. As the Chief

Investment Officer, I continue to oversee the investment decision-making process across the firm, as well as manage all aspects of running the business as President. Nick, who has now been with Wolverine for over three years, is our Chief Market Strategist, and we rely on him to provide insight into market psychology and develop strategies to take advantage of investment opportunities.

I'd like to take a minute to go back and pick up from where we last left off in our conversation about a year ago. I want to quote from our answer to your last question at that time. I said, "We're 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 real economic value 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 various risk management approaches." That advice was prescient then, and it is even more relevant now. While this is a very different environment from the one we were in a year ago, some of the same principles of contrarian investment apply.

some of the things we've learned, and we're about to go out to the investing public with a new portfolio product, which Nick will elaborate on in a minute.

We've busily evaluated the landscape of investment opportunities with a keen eye toward what investors need and want from their investment professionals. Clients want to know their hard-earned savings are not being wasted and that if there's any way to help protect their values, we're going to do it. As a result, we prefer to view the current dangerous market as a point of opportunity. As we survey the investment landscape, we feel it is important to understand and reassess what our core competencies are. For example, one of our strengths is utilizing tools, techniques and strategies that incorporate capital preservation as well as appreciation. Another is the

Caruso: Normally, our extensive fundamental analysis identifies specific investment themes that will respond to emerging growth trends or to cyclical opportunities. Our latest techniques rely heavily on extensive technical analysis to capture only the highest probability profit opportunities by identifying and anticipating outlier price patterns where we target near-term reversion to the mean.

TWST: How did your portfolio perform over the past year and how have your experiences affected you and shaped your investment policies?

Mr. Babyak: During the summer of 2007, we identified and subsequently characterized what we were observing in the credit markets, as well as the mortgage and housing industry, as something akin to an "earthquake." It's quite ironic that a year later, we're struggling to find a new metaphor to describe the current panic and meltdown in the financial markets. If the second half of 2007 was an earthquake, then what we've experienced since September of this year has been nothing short of our economic planet being slammed by an asteroid. The market atmosphere is filled with clouds of smoke, and we're still looking for sunlight to emerge in the form of stabilized markets.

One of the seminal moments for me was something Jack Welch said on CNBC back in mid-September. At that time, when speaking about the attitude business operators needed to have, he pounded his fist on the table and exclaimed, "This is not a time to be under the desk sucking our thumbs!" As I've told our clients, we at Wolverine have not been under our desk sucking our thumbs. As a matter of fact, we have been ardently trying to preserve capital by employing our disciplined approach in new ways, adapting to markedly changing market conditions. Moreover, we're taking

way we develop yield enhancement, derived from interest and dividends, as well as call option premiums. Finally, and perhaps most important given current market conditions, is our specialty in capitalizing on volatility. At this time, I would like Nick to interject and provide his thoughts about some of the innovative things we're working on at Wolverine.

Mr. Caruso: To just give you a little background, before joining Wolverine about four years ago, I spent 35 years with a major brokerage firm, and I have always been a student of the market. To me, it always has been the utmost intellectual challenge of my life. So I have always challenged myself in working with different methodologies in trying to come up with something that I felt would capture the psychology and emotion of the crowd, and hopefully I will be smart enough to create positions that are counter crowd psychology because the crowd usually buys and sells at the wrong times.

I was taught when I first entered the business many years ago that it's a very easy business to understand — you are supposed to buy low and sell high. What we're going through kind of blurs any idea of what's low or high anymore from a price point of view and certainly from a volatility point of view. We have seen things in the last year and a half that most people would never have even imagined. So what I have utilized and have personally benefited from since February 1987 is a compilation of technical, psychological and

other measurements that take advantage of any type of moving average, whether it be an individual stock, a market index or an ETF, that trades on a daily basis and that can measure an overbought or an oversold condition. In other words, I am looking for extremely positive or extremely negative emotional reactions as expressed in the market. My analytical techniques were developed over many years through trial and error, honing and re-honing my methodologies until they proved effective in both bull and bear markets.

we nonetheless embarked on a concerted effort to raise cash. Little by little, we began to build up a small cash hoard across all our non-institutional accounts. As Nick and I began to share our thoughts on what was going on in the markets, we began to see volatility rise, greater government intervention, and less conventional market pricing. We decided to put much of our accumulated cash to work in using our tactical approach in the mid-September time frame, and we've been very pleased with the result attained so far.

Babyak: What we're trying to achieve is a portfolio that is uncorrelated with the market. Following the crowd can have disastrous consequences. To counter this, our totally objective and technical indicators allow us to separate emotion from our investment decision. We've now been executing our tactical approach systematically across most of our portfolios, and we have carved out the overlay into a new performance composite in accordance with our industry performance accounting standards.

In joining John three and a half years ago, I personally have used this program for my own portfolio, and it's something that John and I have formalized over the course of this year, and which we have overlaid on our existing clients' portfolios. We're calling our program the Tactical Opportunity Portfolio, or TOP for short, because tactically it takes into consideration many different elements with the aim of making money in any type of market. In that regard, it can be used as a self-standing type of portfolio or it can be effectively utilized in conjunction with a buy and hold portfolio. This type of portfolio is more short term in nature, which is to say the gains in our portfolios will be primarily short term. The portfolio will exhibit risk inversely correlated to the market, and the returns should be substantially positive as has been proven by many years of experience.

Mr. Babyak: Some have questioned whether there is any difference between our new tactical approach and simply becoming a more active trader. While we've always been actively hands-on here at Wolverine, trading tends to imply more intuition and instinct as opposed to an analytical approach. Recall that our core competencies in convertible securities with the option enhancement are very analytically grounded. We've never espoused a pure buy and hold approach, but we do recognize that a primarily long approach has not preserved capital the way we assumed it would. We noticed something very important that began to occur starting at the end of last year. We weren't quite sure what it was or how to capitalize on it, but

As Nick mentioned, what we're trying to achieve is a portfolio that is uncorrelated with the market. As most folks instinctively know, following the crowd can have disastrous consequences. To counter this, our totally objective and technical indicators allow us to separate emotion from our investment decision. We've now been executing our tactical approach systematically across most of our portfolios, and we have carved out the overlay into a new performance composite in accordance with our industry performance accounting standards. Some might call our new composite a hedge, and I would not argue with that characterization. We felt that we had to come up with a different way of preserving capital in these extremely difficult times. So, as Nick said, we've been managing this new portfolio since the beginning of 2008, and by the end of this year we will have a full year as a standalone composite that we can actively go out and represent to new investors.

TWST: All investors are waiting to see how money management firms will have preserved capital in the current markets. If you have a track record of 12 months in your newest strategy, that's going to be to your advantage, right?

Mr. Caruso: Definitely. As portfolio managers, we've been trained to assess investment opportunities that we uncover by continually anticipating changes in various sectors of the economy. Normally, our extensive fundamental analysis identifies specific investment themes that will respond to emerging growth trends or to cyclical opportunities. Our latest techniques rely heavily on ex-

tensive technical analysis to capture only the highest probability profit opportunities by identifying and anticipating outlier price patterns where we target near-term reversion to the mean. We apply proprietary trend analysis to assess varying market conditions to enact the appropriate buy or sell trades using various instruments of investment, including ETFs, market indices, sector funds or individual common stocks.

about every index imaginable from various sectors to indices, whether you're talking about the S&P, Dow Jones, or Russell indices. They have even developed indices that have twice the correlation, both up and down, of their respective indices. So, if the S&P is up or down 5%, then there is an ETF that will go up or down 10%. These are the tools that we're using to overlay on our current portfolio clients to achieve non-correlation and positive portfolio performance.

Babiyak: As ETF developers come up with new products, we as opportunistic portfolio managers are coming up with new uses and new strategies to help our clients. We haven't abandoned our longstanding core competencies. But in concert with new market realities, we are fine-tuning our competency in the area of managing risk and capitalizing on volatility, relying more on our creativity and vast experience to adapt to change.

Mr. Babiyak: I want to emphasize that we haven't abandoned our traditional long-term, yield-enhanced investment approach, but we do recognize that we're in a totally different environment. Just think about the role our federal government has taken in attempting to micro-manage our national economy. As I look back to the failure of Bear, Stearns, I have to wonder what might have been if the Federal Reserve hadn't intervened to orchestrate the acquisition of Bear by **JPMorgan**. A market crash might have been conveniently avoided last March, but I would contend that free market principals have been locked up in a stranglehold ever since.

We're now obviously in a recession, we don't know how long or deep it's going to be — it could be quite severe and longer than any other postwar slowdown. Judging by the retraction in stock prices, the market clearly has discounted something akin to a mild depression. The outlook for corporate earnings is totally up in the air, so we really have a hard time doing traditional fundamental analysis. Certainly there are pockets of opportunities, and some of the investments that we've made in the last month have taken advantage of the market lows and have performed quite well. But the markets have a lot more work to do to establish a base and to reflect the rebuilding of confidence in the US financial system. When viewed with a long-term perspective, whenever markets exhibit extreme negative sentiment, we would contend that investors should interpret these moments as attractive entry points.

TWST: Let's get down to specifics. What exactly are you doing with these different strategies to take advantage of the extreme market volatility and new economic landscape?

Mr. Caruso: One of the really nice tools that have been developed over the last couple of years are the so-called exchange-traded funds, or ETFs for short. Today they have baskets that represent just

The one that we've been focused on, only because it is a measure of the broad equity market, is the double short ETF known as the **SDS**, which is a ProShares product. We've tested this again and again over the course of the year and we have found that there is a very high likelihood that it is properly, inversely correlated. However, we have discovered that some of these products don't seem to hold up under the same scrutiny. For example, all year long we have tracked the performance and price behavior of the oil index. ProShares has an ETF that tracks the bullish performance of the oil sector, and another ETF that tracks the bearish performance of this same sector. We found that the bullish ETF, known as the **DIG**, has been properly correlated, both in terms of direction and magnitude of oil sector performance during the last three months. However, we observed that the bearish ETF, known as the **DUG**, did not exhibit the proper correlation on the downside performance of the oil sector. In fact, during the period between August and October when the **DIG** declined by 40%, the **DUG** did not make any money. This came as a total surprise to us, and we have avoided using the **DUG** to represent our bearish outlook for the oil sector. So you've got to be very careful when employing the new ETFs. We've done our homework and are trading only those ETFs that have a very tight correlation with very low dispersion. In general, when we receive a negative, or sell, indication and we want to participate to the market downside, we've been strictly buying the **SDS**. When we receive a positive, or buy, signal and the prevailing market trend reverses, we've been buying the **SSO**. Again, both of these ETFs are issued and managed by ProShares.

Mr. Babiyak: I want to emphasize that the methods that we're using in our tactical opportunity portfolio are pretty well time-

tested, and we have found that, unlike portfolio insurance in the late-1980s, the new long/short funds have been performing exactly as advertised. As ETF developers come up with new products, we as opportunistic portfolio managers are coming up with new uses and new strategies to help our clients. Again, I want to reiterate that we haven't abandoned our longstanding core competencies. But in concert with new market realities, we are fine-tuning our competency in the area of managing risk and capitalizing on volatility, relying more on our creativity and vast experience to adapt to change.

I was recently asked by a pension executive at a Fortune 100 company, "How are you managing through all this extreme volatility?" Honestly, on the one hand, I admitted that it's been extremely tiring. I've harbored no illusions as to the exhaustion that I've been experiencing. But I went on to explain to my friend that the past three months have also been tremendously exhilarating. Painful times require difficult soul searching, which makes our relative successes amid the current despair that much more gratifying. By the way, not everything that we've bought and sold in the tactical portfolio has yielded a large profit, but losses are kept to a bare minimum. And while most of our core, long-term holdings are down, the one bright spot has been that the tactical opportunity portfolio has produced substantial, positive returns that have been inversely correlated with the general market direction.

Caruso: Many investors are carrying large capital losses, especially those incurred this year, that could be applied toward our expected portfolio gains. Of course, our portfolio could be very effectively utilized in tax deferred and retirement accounts where there are no taxes due until the funds are withdrawn from the account.

TWST: Tell us more about your newest portfolio strategy. Would you provide a recent example of a trade that worked to your advantage?

Mr. Caruso: The focus of our Tactical Opportunity Portfolio is to identify price aberrations that become extended, and more important, to then take action to capitalize on them. Just as we saw in the oil sector earlier this year, which obviously has experienced a severe downturn, or in virtually every other commodity as well, when psychology and price action indicate irrational exuberance or irrational pessimism, our indicators should guide us to be on the correct side of the market's direction. There are many sources that affect our analytical indicators, which can be economic, social, fundamental or even political.

Mr. Babyak: For example, let's briefly look back on our trading strategy surrounding the presidential election that just con-

cluded. The rally into election day was a clear sense of relief that the long campaign cycle was finally over. There is no question the new President is facing tremendous challenges. There was a sense of true exuberance, regardless of what side of the political spectrum you are on. We felt the rally into election day would not hold up. In fact, our indicators were telling us that we were reaching a short-term cyclical peak. Moreover, we were up nearly 20% from the prior week's lows. We then relied on our discipline, our new methods if you will, and put the overlay strategy into very positive effect. Our trade worked out as advertised.

TWST: Are there any tax or trading considerations that investors should be aware of in your strategy?

Mr. Caruso: Many investors are carrying large capital losses, especially those incurred this year, that could be applied toward our expected portfolio gains. Of course, our portfolio could be very effectively utilized in tax deferred and retirement accounts where there are no taxes due until the funds are withdrawn from the account.

Mr. Babyak: That actually brings up an interesting point. Heretofore, you couldn't directly sell short in an IRA or an ERISA account. By buying the short ETF products, for regulatory and tax purposes, the holder is considered long a stock. The other nice feature of the short ETFs that comes into play is the way dividends are treated. When shorting the stocks of individual companies, the seller

becomes liable for the dividend. As the owner of the short ETF, the holder doesn't have this onerous liability. Our approach is not a panacea to the current market turmoil; there are pros and cons to any market strategy.

One more positive factor, however, is how owning a short ETF actually helps circumvent the short selling rules, where you need to identify the source to borrow stock before you can short it. In speaking to convertible arb traders, and long/short hedge fund managers, they've had a daunting time coping with the current environment where new restrictions have been placed on their ability to operate. On the other hand, we are not encumbered by these restrictions. The execution may appear straightforward, but it is our in-depth analysis that gives us confidence in our discipline — we have developed a true proprietary methodology.

TWST: What is your outlook for the US economy?

Mr. Caruso: Our economy will encounter numerous headwinds during the next two years, and that includes the world economy. The International Monetary Fund recently revised its global growth forecast to 2.2%. Anything under 3% is considered a worldwide recession. In the next three years, Europe alone has debt maturing of \$2.1 trillion. Certainly, the credit crunch is not over in Europe, and in the US, **General Motors, Ford** and

One real estate analyst we know suggested that the housing starts report is one of the best leading indicators. Historically, economic recovery occurs from five to six months after housing starts have risen for three consecutive months, suggesting we are perhaps six to eight months from the end of this recession. Similarly, stock market bottoms anticipate and predict the end of recessions by four to five months. So if you ask me for my best estimate for a market bottom, I would have to say sometime in the next couple of months.

***Babyak:** Our firm usually acts as a subadvisor, implementing our various convertible and volatility strategies across multiple separate accounts to attain consistency and low dispersion across the specific institutional platform. We're going to continue to service all our clients and use our core strategies to preserve capital and generate superior risk-adjusted returns over the long term. We also think that our newest portfolio is going to open up a range of heretofore untapped possibilities for us.*

Chrysler are faced with an interesting bailout decision by the government. We clearly need coordinated global, fiscal stimulus and unfortunately, this year, the Grinch will steal Christmas from many boys' and girls' stockings. The Chinese recently tried to help their own cause in passing a \$586 billion infrastructure bill, which they need in order to propagate their continued above average growth rate. China's economy will not be immune from the current global slowdown. We're very confident that the US government will enact an infrastructure stimulus package in the first 100 days of the Obama Administration.

Mr. Babyak: Marketwise, I don't know a single soul who won't be extremely thankful when this year is finally in the books. We remain cautious and concerned about the state of our so-called free market system and the level of pessimism that has permeated the entire investment community. On the bright side, the high level of extreme volatility we've been experiencing the past two months is much more indicative of the conclusion of a major market trend, and in our opinion not the beginning of a new trend.

Gloomy economic data, uninspiring testimony from the Detroit Three automakers, and a sharply lower GDP forecast from the Fed have sent many individual stocks to new lows. We continue to assert that the linchpin to our entire economic and market outlook is identifying the point where we can confidently declare an end to the housing market decline. Consequently, we are keeping a keen eye on housing starts, which plunged 4.5% in October to 791,000 annualized, as building permits plummeted 12%.

Many market pundits generally feel the Federal Reserve Board has been overly optimistic about GDP and unemployment. Perhaps that's because the Fed is running out of ammunition to combat the current credit and banking crisis. Obviously, the Fed has the ability to lower the fed funds rate by only another 1%, before reaching absolute zero. Unfortunately, the financial markets have not been responding positively to prior government intervention. Fewer and fewer investors have confidence in Treasury Secretary Paulson, especially after he said there was no real game plan or playbook for the current financial crisis. In other words, Paulson is purely shooting from the hip with over \$1 trillion in bailouts and rescues so far this year.

TWST: Do you have international exposure in your portfolio? Also, what is your outlook for the US dollar?

Mr. Babyak: I would never want to suggest that we are international investment experts. However, we're certainly cognizant and knowledgeable about the inter-relationships between currencies and the global economy, as well as recognizing shifts in international investment sentiment. By and large, we consider ourselves generalists and our international knowledge is primarily at the macro level, as opposed to understanding opportunities in specific foreign companies. Clearly, our discipline and new tactical overlay opportunity fund is applicable in any public market, and, as Nick said, wherever there is a tradable market and crowd psychologies at work, we have an opportunity to capture those swings in sentiment.

Mr. Caruso: I can tell you that our indicators clearly identified the low in the US dollar late last spring.

Mr. Babyak: Yes, in fact, around that time we began buying a dollar bullish ETF, with the symbol **UUP**, for several of our accounts. We have lightened up recently on indications that the extreme short-term rally may be overdone; although being long the dollar is not a major investment theme here, we clearly noticed that a rebound in the dollar was long overdue, and we have simply been exploiting the recent trend change to our advantage.

Mr. Caruso: To me, the recent strength in the US dollar indicates we are simply the first country to enter an agonizing recession. There is now clear evidence that the UK and Europe have joined the US in a recessionary economy. I also think that we will be the first country out of this recessionary period. The demand for the dollar indicates just how much worse other countries are going to be in the upcoming year in relation to the United States because the demand for dollars simply has been incredibly strong.

Mr. Babyak: Remember when they used to say, “When the US sneezes, the world catches cold?” I think that still holds true, but

their money out. It looked like the lock up would last for only week or two, but they froze access to client funds for nearly two months. And this fund only had a few hundred million dollars invested in it. Can you imagine if investors couldn’t get access to the trillions invested in money market funds across the system? So there have been little pockets of severe distress all around, including the commercial paper market.

The commercial paper market was an area of great distress that also hit close to home. For a couple of clients, we own some **GE** commercial paper, and there were days this past September when I called various OTC trading desks to get a bid on what should have been a very liquid, short-term investment vehicle. Our particular **GE** paper matures in February 2009, but I was told there were no bids. That was really shocking to me. A few days later, when I again went out in search of a bid, we found this AAA **GE** paper selling for 94 to 95 cents on the dollar. This price effectively creates an absolute yield to maturity of a high single-digit return for super high-quality **General Electric** paper. It was an incredible, eye-opening experience, to say the least.

Caruso: In 2009, there will be fits and starts and we will have bear market rallies as well as bull market corrections, and volatility clearly will continue to be extremely high. What we’re trying to do is utilize volatility as an opportunity to profit. So far, we can say to you that we have been able to correctly measure, analyze and act on various market extremes.

now the saying should be when the US catches a virus, guess what? The world also catches the same virus and we get sick together.

With regard to China, a possible 6% or even 8% growth rate is considered a recession in that country. While still growing, China obviously has severe domestic pressures in terms of avoiding a revolt from the people. They really can’t afford to allow their economy to dip down into a mid-single-digit growth rate.

TWST: What things worry you most about the general economy and the current state of US markets?

Mr. Babyak: We came very close to a total seize-up in the credit markets this past September, which was tremendously concerning for those of us in the financial industry. At the time, any professional wouldn’t dare admit just how close we came to a massive financial systemic breakdown. One can get an inkling of a condition that could have been much more pervasive. I’m talking about the lock up in the Reserve Fund’s money market mutual funds. Tremendously disconcerting. One of our co-portfolio managers here in the office had his clients in the Reserve Fund, and he couldn’t get

Mr. Caruso: A Goldman Sachs economist recently predicted that the current calendar quarter is going to be the worst performing quarter in the US and that unemployment could reach 8.5%. Goldman also believes that the US next year will have a GDP of somewhere about 1.2%. There is going to be a period here of economic stabilization, but it’s not going to be in the next few months. In 2009, there will be fits and starts and we will have bear market rallies as well as bull market corrections, and volatility clearly will continue to be extremely high. What we’re trying to do is utilize volatility as an opportunity to profit. So far, we can say to you that we have been able to correctly measure, analyze and act on various market extremes.

TWST: Most managers consider risk management only as it relates to managing individual securities, or perhaps at the portfolio level. Now you’ve taken risk management to a new level by incorporating macro events, market psychology, and technical research into a tactical allocation overlay. What conditions caused a change in your approach to risk management?

Mr. Caruso: Who would have ever thought that Lehman Brothers', Merrill Lynch's, Morgan Stanley's, Citigroup's, and even Goldman Sachs' basic structures would be turned upside down. As for Goldman and Morgan, although they are banks, they need to accumulate deposits and that's going to be their immediate goal. Whoever has the most demand deposits has a distinct advantage going forward. Initially, there were nine big banks that received the first capital infusion from the Treasury, and these institutions are the ones our government believes will be the survivors of our new economic landscape.

The entire financial system has changed dramatically. We are experiencing a massive deleveraging throughout the world and, accordingly, the entire banking structure. The investment banks will be operating under new rules and regulations, where the leverage ratios they previously employed are now obviously out of the question. So when they do re-emerge, these major money center banks will get most of the business, but profits as we knew them to be in our industry will grow much more slowly than in the past.

Mr. Babyak: When trying to place the current market environment into layman's terms, I'm reminded of a football field. What we have witnessed in the last year is akin to an investment game played on a field where the sidelines expand and contract daily, and the length of the field changes instantaneously. We've been trying to play a traditional game on an asymmetric field. We do feel, however, that our new, somewhat unconventional approach has a very strong role to play here in this asymmetric investing climate.

Mr. Caruso: Or, in other words, we are offering unconventional strategies for unconventional markets.

TWST: Who are your typical clients and who will benefit most from your tactical overlay?

Mr. Babyak: Let me address the first part of your question, and perhaps Nick could take the second part. Our clients are generally equally divided between institutional relationships and what I refer to as direct client relationships. Our direct clients are primarily individuals — high net worth investors who include physicians, attorneys, small business owners and corporate retirees, basically very successful people. For our institutional clients, our firm usually acts as a subadvisor, implementing our various convertible and volatility strategies across multiple separate accounts to attain consistency and low dispersion across the specific institutional platform. We're going to continue to service all our clients and use our core strategies to preserve capital and generate superior risk-adjusted returns over the long term. We also think that our newest portfolio is going to open up a range of heretofore untapped possibilities for us. Institutions are more than welcome to embrace our Tactical Opportunity Portfolio.

Mr. Caruso: We think that at least initially, our first priority will be the individual investor. John and I are willing to lower the

account minimum because our tactical opportunity portfolio can be used as a standalone portfolio. So the minimum participation might be as low \$100,000, which we think is very affordable for substantial investors who can hopefully make back some of the money lost in this bear market, or they might use it for tax purposes to generate short-term gains. Either way, we're hopeful investors will understand the merits of our non-traditional approach.

We're looking to reach out to new investors, expand our market opportunities through your readers and our other marketing efforts. We're optimistic that our time-tested proprietary strategy will create very superior returns in both bull and bear markets.

TWST: It's good to hear such a positive tone from you, and to see that you are taking advantage of the opportunities that other professional investors are scared to death of.

Mr. Caruso: The final proof will come at the end of December, when we have one year of operation in our new tactical portfolio product under our belt. At the rate of return we are currently experiencing, we think we will have something very positive to present to the investing public.

TWST: Is there anything that you want to add?

Mr. Babyak: We can't thank *The Wall Street Transcript* enough for the opportunity to talk with you and reach out to your audience. Normally, in these interviews, we go to great lengths to extensively discuss the fundamental attributes about our individual stocks and so forth. But these challenging and stressful times have motivated us to think outside the box, and we would urge all investors to take an interest in uncorrelated strategies that blur the lines between traditional asset classes. The era of blindly buying stocks or bonds and holding them indefinitely has ended. We would certainly welcome the opportunity to explain more of the advantages of our various strategies to capitalize on the market's volatility.

TWST: Thank you.

Note: Opinions and recommendations are as of 12/2/08.

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