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INVESTMENT PHILOSOPHY AND STRATEGY

It is our goal at Capital Strategies to provide the appropriate investments for our clients given their stated risk tolerance, investment time horizons and the variability of the financial markets. We define risk from a volatility standpoint, the impact of inflation and the potential loss of principal. Our primary responsibility is to protect our clients from serious losses of principal. We consider the financial markets as both domestic and foreign equities (stocks) and fixed income (bonds).

We recognize that it is a difficult task for most individual investors to construct an investment portfolio that provides the right mix of current income, steady growth potential and long-term security. In addition, the need for constant monitoring, portfolio updating, and making appropriate changes in their portfolio based on financial market conditions and personal circumstances is not only time consuming but outside the scope of knowledge for most investors.

We believe that we can add significant value to our clients in this area. Eric and Mark have over 40 years of combined experience in the financial markets. We feel confident that we have the investment knowledge necessary to guide our clients through the financial market cycles effectively. It is interesting to note that the average investment experience of a mutual fund manager today is less than ten years!

We also believe that our clients' long-term investment track record with us reflects this. We structure our clients portfolios based on optimizing their returns while providing the right mix of investments based on their individual temperament and personal financial situation. We believe that we can continue to provide competitive investment returns for our clients while exposing them to lower risk of loss of principal.

We feel strongly that asset allocation/diversification is the most important issue facing any investor today. It is through a careful analysis of the various asset classes that we select a strategic asset allocation plan for our clients to minimize risk and maximize potential returns. Studies have shown that asset allocation accounts for more than 90% of the variation in portfolio performance, ("Determinants of Portfolio Performance" by Gary Brinson).

A properly allocated portfolio is more likely to participate in long-term market gains while reducing exposure to short-term market volatility. This diversity, we believe will protect our clients from the extreme volatility of the financial markets and reduce the potential for serious loss of principal.

Our investment strategy is implemented by structuring a diversified portfolio of mutual funds made up of above average fund performers and the appropriate mix of funds given the current economic environment. While we may lean toward different market capitalization levels (market size of the stocks that make up the fund portfolio) or different investment styles at various times during the market cycle, we will not focus entirely on a market segment like large capitalization funds or only value oriented funds.

We do not favor funds that are especially volatile from period to period. We would rather try to beat the financial market benchmarks by 1% to 2% every year than to beat it by 10% one year and then underperform it by 8% the next year. It takes substantial returns to make up for the loss of principal. We also believe that preservation of capital is a far more important aspect of long term portfolio management than a growth orientation.

We structure our client portfolios entirely with no-load mutual funds. Why no-load mutual funds? We believe that not only is the flexibility of choosing from over 4,000 no-load funds very advantageous but cost effective as well. When you can invest with the very best investment managers in the world for a very low cost it is hard to make a case for paying a load/commission to anyone. It is also impossible for a family of funds (American Funds, Fidelity Funds, and Vanguard Funds etc.) to offer the cream of the crop in all of the various market segments. Further, we believe it is imperative to have the ability to change funds without cost or penalty to take advantage of varying financial market conditions to maximize investment returns for our clients.

We believe that we know how to evaluate and pick mutual fund managers for our client's portfolios. This is both a time consuming and exacting process. We understand that it is not the recent performance of a mutual fund that is the most important. It is the long term track record of the fund manager through several market cycles (at a minimum one complete market cycle) that is critical for us to see and evaluate. It is easy to make great returns when the financial markets are running at all time high levels. We look for the ability of fund managers to handle financial market downturns as a critical factor so we can protect the investment principal of our clients.

Every mutual fund manager tries to select the best investment in his or her area of the financial market, regardless of the prospects of the overall financial markets. For example: a growth fund manager attempts to find the growth stocks with the best risk/reward for the type of stocks they specialize in. Even though they may feel that bonds may out-perform stocks in the near term, they will not buy bonds. That is not their job. That is our responsibility. We are not specialists in picking individual stocks or bonds for a mutual fund. We can, however, select funds that we believe will perform on a long-term basis for our clients given the current level of the financial markets and the economic environment.

We monitor the funds that we select, if they under-perform relative to their peers in their market segment, we replace them. If the financial markets or the economy change we may increase or decrease exposure to a particular fund or market segment. In this way we believe that we compliment the work of the fund manager. They function on individual securities level while we work with the clients' entire portfolio. We do this by taking into account the clients goals, risk tolerance and investment time horizon. We believe that long-term results are more important than short-term results.

As a fee only investment management firm we are compensated on a percentage fee on the amount of assets under our management. We have tried to put ourselves on the same side of the table as our clients. It is through the success of our clients that we attain our success!

We hope this is helpful in your understanding of our approach to investing.

Eric C. Graber
President

Mark A. Carlton, CFA