

Capturing Growth Potential

A New Pathway to Alpha

June 2009, White Paper

ABSTRACT

The purpose of this paper is to illustrate that a hybrid form of stock selection, one that combines fundamental judgment with a quantitative definition of internal growth potential, or earnings power, can generate excess returns with low volatility on a consistent and repeatable basis. It does this by taking advantage of two market pricing anomalies: (1) the market's slow reaction to the change in predictive balance sheet variables, and (2) post-earnings announcement drift.

The concept of "buy low and sell high," dictated by fluctuations in price and PE ratios, is usually a small win proposition. For the long-term investor in stocks with positive growth potential profits can be significantly greater. However, of the thousands of stocks to choose from fewer than 20% will be above average performers and even fewer will become super stocks. To find these and capture their growth potential requires a different approach than relying on traditional Wall Street methods, such as price changes and assumptions about future earnings.

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The goal of active management is to add value by selecting stocks that outperform a broader index on a consistent and repeatable basis and with less volatility than the index itself. Since active management is a zero-sum game, this requires an active manager to have a competitive edge. Typically, those who earn alpha have the capability to exploit market inefficiencies at the expense of other investors who are subject to behavioral biases or less sophisticated analytics or processing skills.¹ Generally, this requires leverage with the discipline of quantitative models that exploit undervalued stocks, but competitors with similar models generally cause the effectiveness to decay in a matter of months. Also, with the focus on undervalued stocks these models often fail to generate alpha in a market that rewards growth stocks.

A more effective way of capturing value from mispriced stocks has been developed by Beacon Street Capital, LLC. This strategy is supported by academic studies which show that changes in key balance sheet items can predict the growth potential of cash flow and that the market is slow to react to such changes, thus creating a mispricing anomaly. By using the quarterly changes of these predictive balance sheet items to create a quantitative trading system, growth potential can be captured before the market prices it in or out through its normal valuation process. As the following illustrations will show, tracking the growth potential of individual companies provides a new pathway to generating alpha, one that is more consistent through various market cycles than traditional methods that rely on estimates of future value or market timing. Furthermore, risk can be reduced by applying this methodology to financially strong companies that are profitable and cash flow positive.

PERFORMANCE IN VARIOUS MARKET CYCLES:

The following tables show the returns of this methodology against a benchmark index during various market cycles. The S&P500/Select represents composite returns and defaults to cash when few stocks are available - combining cash with captured growth potential minimizes downside risk. The Institutional LCG (large cap growth) is a tracking portfolio created from the actual trades of the composite S&P500/Select, with quantities adjusted to maintain full investment to maximize the capture of growth potential, which also reduces risk while enhancing the return on the upside. *See page 13 for details of this process.*

The S&P500/Select returns are “net” of fees & include dividends; the Institutional LCG returns are “gross” of fees & exclude dividends.

a. Period 12-31-01 (inception) to 3-31-03

Bear Market	
S&P 500/Select	-13.21
Institutional LCG	-19.69
Russell-1000® Growth	-28.65

b. Period 3-31-03 to 10-31-07

Bull Market	
S&P 500/Select	76.63
Institutional LCG	109.80
Russell-1000® Growth	86.49

c. Period 10-31-07 to 3-31-09

Bear Market	
S&P 500/Select	-35.43
Institutional LCG	-38.29
Russell-1000® Growth	-43.35

d. Period 3-31-09 to 6-30-09

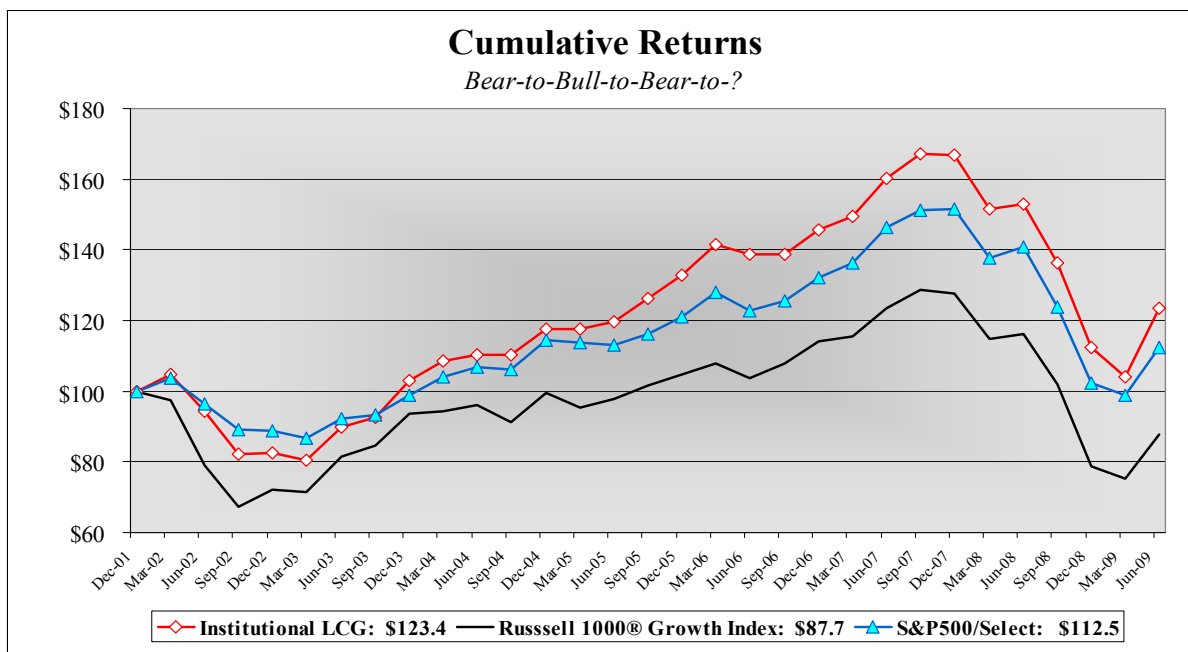
? Market	
S&P 500/Select	13.64
Institutional LCG	18.69
Russell-1000® Growth	16.31

1. *Investing Separately in Alpha and Beta*. Research Foundation of CFA Institute; Roger G. Clark, Harindra de Silva and Steven Thorley.

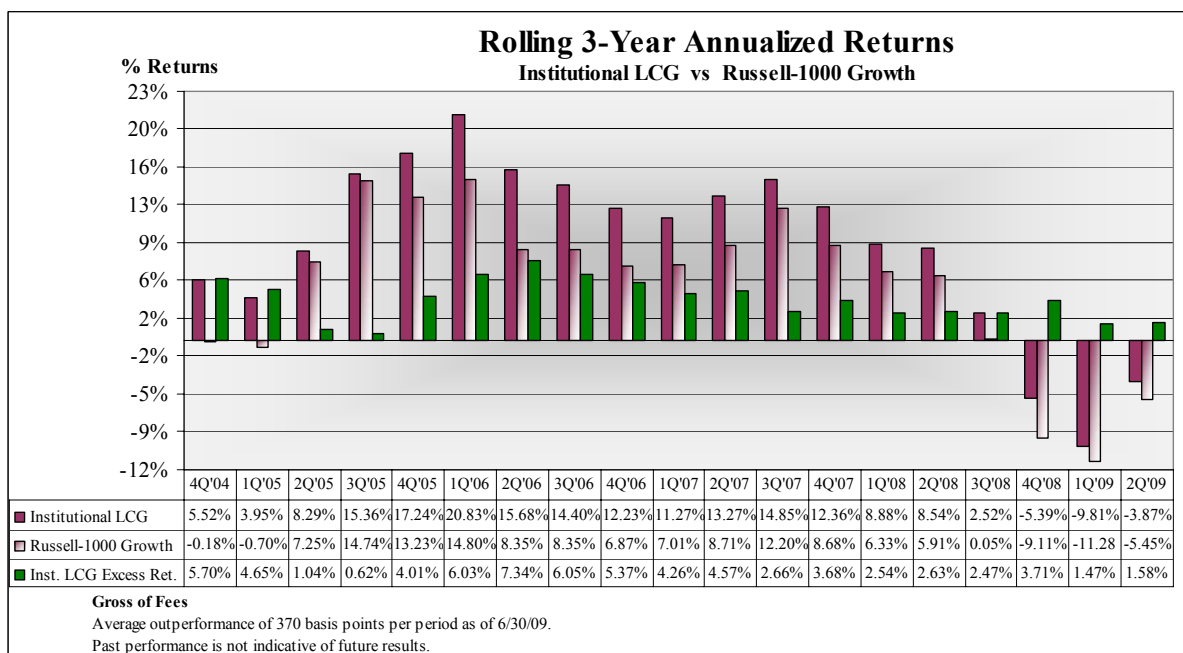
e. Period 12-31-01 (inception) to 6-30-09

S&P500/ <i>Select</i> vs Russell 1000 G	
Excess Return	24.8
Average Alpha	2.6
Standard Deviation	12.5

Institutional <i>LCG</i> vs Russell 1000 G	
Excess Return	35.7
Average Alpha	3.6
Standard Deviation	18.1



Capturing growth potential through the Institutional *LCG* strategy maximizes the value added over the long-term.



EXTRACTING VALUE FROM ACADEMIC RESEARCH

It is well established in academia that accounting procedures related to balance sheet changes provide clues to changes in the direction of growth potential which the market eventually prices in or out as a growth premium^{2,3}. What is not well known is how to take advantage of this pricing anomaly. Beacon Street Capital has identified 26 of these predictive markers, such as inventory, payables, receivables, plant and equipment, debt, etc. These variables are weighted according to their contribution to growth and combined into a summary measure we call the **Q.E.P. (Quantitative Earnings Power) Index**. The quarterly change in this growth sensitive Index represents the growth premium the market adjusts to when the external factors supporting it become known. Since the market is slow to react there is a temporary mispricing of a stock which we are able to capture by using the quarterly change in the Index as a buy/sell mechanism. Our competitive edge, therefore, comes from the discovery that

*while the Q.E.P. Index is not sensitive to changes in price,
prices are sensitive to changes in the Index.*

MARKET PRICING ANOMALIES

Without any consideration of economic foundations, when quarterly financial statements are released a change in the Q.E.P. Index of a stock often yields insights into the subsequent up or down movement of that stock's price as market participants adjust to the new data. This market mispricing anomaly is corrected in two stages, with the first being related to expectations from prior period information and is corrected rapidly once the new data becomes available. The second pricing anomaly is known as "post earnings announcement drift" which is associated with future periods and is normally corrected over the next several weeks. Beyond that, if the trend in the Q.E.P. Index is positive, and should the positive trend continue, there exists an opportunity for a concentration of abnormal returns in quarters after the mispricing exists. The direction and magnitude of these returns should be consistent with the direction and magnitude of the predictable bias revealed by the previous quarterly change in the Index. This opportunity to capture these excess returns in response to the change in growth potential is what makes the Q.E.P. Index a successful leading buy/sell indicator.

²*Financial Statement Analysis and the Prediction of Stock Returns*, Jane A. Ou and Stephen Penman. Journal of Accounting and Economics 11 (1989) 293-329. North-Holland. Financial statement ratios are converted into a summary measure that probabilistically indicates the direction of change in future annual earnings. The strategy produces substantial portfolio abnormal returns by detecting deviations from fundamental values.

³*The Prediction of Stock Returns Using Financial Statement Information*, Robert Holthausen and David Larcker. Journal of Accounting and Economics 15 (1992) 373-411. North-Holland. A trading strategy which is based on the computerized fundamental analysis of financial ratios is successfully designed to produce future abnormal stock returns.

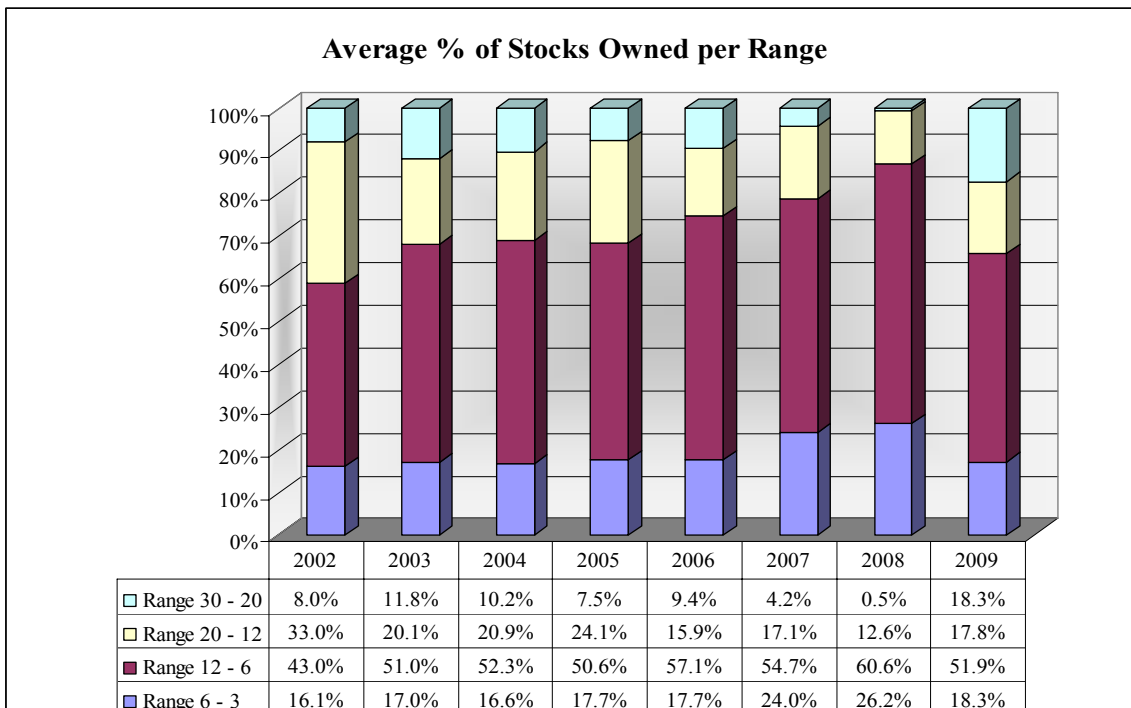
QUANTITATIVE EARNINGS POWER (Q.E.P.) INDEX

The Q.E.P. Index is essentially an earnings leverage model. It looks at the rates of change in sales and earnings relative to the rates of change in capital investment items (which impact the various line items in the balance sheet) in the business. The relevant basic capital investment categories are Shareholder’s Equity, Long-Term Debt and Working Capital. The basic sales and earnings categories are Revenues, Operating Expenses and Dividends.

$$\text{Q.E.P. Index} = f\{\text{SHE, LTD, WC, REV, OP EXP, DIV}\}$$

Within the Working Capital component, additional weight is given to changes in inventories as well as to the trends and levels of receivables and payables. The Index is configured as a reverse indicator which trends lower as growth potential improves, with the company’s stock price following in the opposite direction over time. As the trend moves lower not only does the value of growth potential increase but the stability of growth potential also improves which diminishes the impact of market volatility, or systematic risk.

Stocks with the most stable growth potential are those with an Index that ranges between 30 at the high end and 3 at the low end. Above 30 growth potential is less defined, thus price is influenced more by market factors. Below 3 competitive equilibrium sets in and growth potential eventually turns negative. Within these boundaries growth potential becomes less influenced by earnings and more by capital allocation which is controlled by management. Therefore, as the Q.E.P. Index moves down growth potential becomes more clearly defined to market participants who can then make better judgments as to its current change in value. This, in turn, makes that value less influenced by market volatility. Consequently, all stocks we purchase are in this 30-3 comfort zone, with the majority being in the mid-range of 20-6.



THE Q.E.P. INDEX ILLUSTRATED

The impact on the Q.E.P. Index to changes to the individual inputs can only be looked at in isolation because they all work in equilibrium with each other. The following are some examples.

The amount that a change in LTD would affect the Q.E.P. Index is dependant on the quantity of LTD relative to the other Capital Investment items on the balance sheet. For a company with a moderate amount of LTD relative to SHE, a 10% increase in LTD in isolation would improve the Index trend by 4%. However if LTD is very small relative to SHE, as may be expected in a rapidly growing technology company, a 10% increase in LTD would have essentially no effect on the Q.E.P. Index although the change would be marginally positive.

Within the WC category the direction and magnitude of change to the Index depends on the actual WC item and the overall size of WC relative to other investment items. For a company with a typical level of WC overall, a 10% increase would be negative to the Index by 6%, while a 10% decrease would be positive to the Index by 5%. For a company with a small amount of WC, changes would have a smaller impact on the Index.

For an item within WC, like Inventory, an increase would generally be viewed as negative in isolation, and a 10% increase would change the Index by 2% in a negative direction. But the larger the Inventory relative to overall WC, the greater the impact the same 10% change in Inventory would be expected to have on the Index. When the components of working capital are “bundled” together there is some offset between positive and negative items with the stronger ones winning out to get a net positive or negative change in the Index.

From a Revenue, Expense and Dividend perspective, a 10% increase in Revenues, all else equal, for a high profit margin company would impact the Index positively by 14% while for a lower profit margin business the impact on the Index would be 10% positive. An increase in Dividends paid, all else equal, is negative to the Index, but is highly dependant on the level of Dividends relative to revenues and expenses for the business. For example, if a company is increasing its Dividends paid at a greater rate than earnings growth this would be negative for the Q.E.P. Index but may result in an increase in the company’s stock price in the short term. Longer term it would be expected to be negative to the value of the company as the company obviously has fewer profitable projects in which to invest capital so capital is returned to shareholders. This company is probably approaching the “competitive equilibrium” phase with a Q.E.P. Index in the low single digit range while a company expanding Revenues and paying fewer Dividends would be expected to be higher up in the Q.E.P. range with plenty of room for growth as it moves down the Index curve as the business expands.

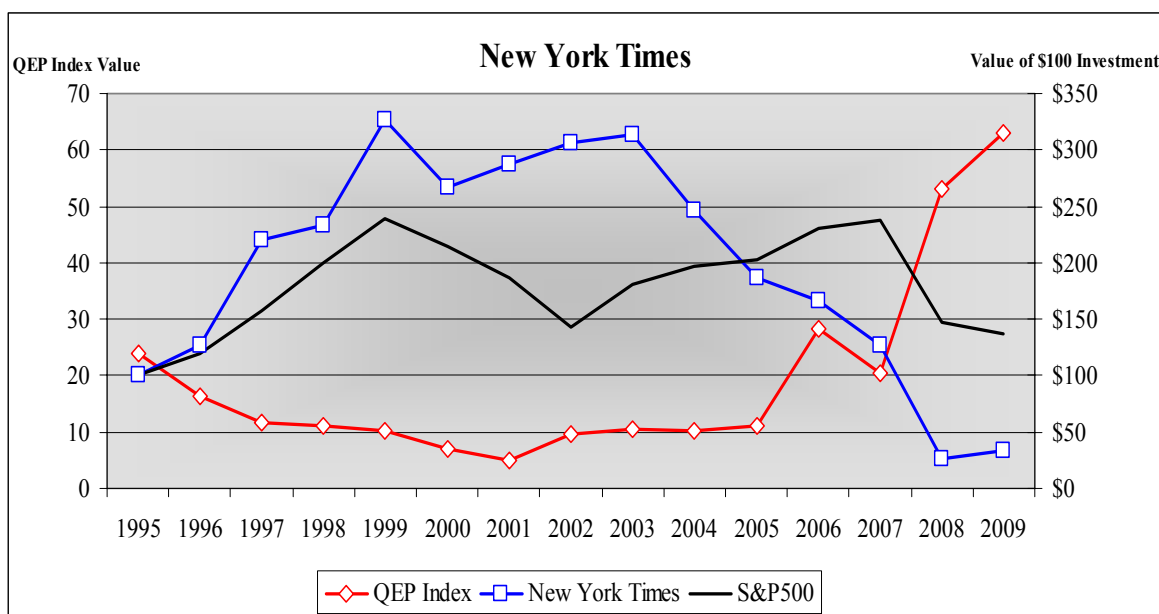
CASE STUDIES

The data points for the Q.E.P. Index are computed quarterly from financial information drawn from the individual companies’ 10-Q and 10-K filings, but illustrated in these case studies on an annual basis at year end. The investment returns over the indicated period are based on historical data and should not be considered indicative of future returns. The graph and related disclosures in no way reflect our forecast of future financial performance.

THE NEW YORK TIMES (NYT):

Year 1998 In May, 1998, *Value Line* wrote that the New York Times Co. (NYT) had enhanced its business profile during the 1990's by focusing on its traditional newspapers, primarily the *New York Times* and the *Boston Globe*, and the development of online news and information services. New printing and distributing facilities started in the prior year gave NYT a competitive edge in its strategy to build a larger circulation outside of New York. This allocation of capital toward growth potential was evident in the positive (downward) trend in its Q.E.P. Index. With a strong economy the paper increased its newsstand price by 25% and acquired another Massachusetts paper (*Telegram & Gazette*) to develop synergies with the *Boston Globe*.

Year 2000: By the year 2000, the *New York Times* had become a national paper with a popular Sunday edition that helped draw the national advertisers and stimulate demand for premium-priced color pages. A slowdown in the economy had an adverse impact on advertising revenue and the stock's price declined with the market, yet NYT continued to aggressively re-purchase its shares with funds obtained from the sale of its Magazine Group. While the S&P500 Index continued to decline, growth potential for NYT continued to be positive and the stock price began to rebound in 2001.



	Year Ended December 31							
	1995	1996	1997	1998	1999	2000	2001	2002
New York Times	\$100.00	\$126.67	\$220.00	\$233.33	\$326.67	\$266.67	\$286.67	\$306.67
S&P500Index	\$100.00	\$120.29	\$157.47	\$199.51	\$238.47	\$214.29	\$186.36	\$142.86

	Year Ended December 31						
	2003	2004	2005	2006	2007	2008	1Q09
New York Times	\$313.33	\$246.67	\$186.67	\$166.67	\$126.67	\$26.67	\$33.33
S&P500Index	\$180.52	\$196.75	\$202.60	\$230.19	\$238.31	\$147.40	\$137.18

Year 2002: 2002 was a key turning point, which in hindsight proved fatal. There was a surge in circulation revenues and an increase in readership due to its national expansion. However, the company made a couple of key strategic investments with a purchase of 15% of the New England

Sports Ventures, which owns the Boston RedSox, Fenway Park and 80% of the New England Sports Network. It also spent \$100 million to acquire 50% of the Discovery Civilization Channel with the hope that these investments would provide additional outlets for its current media holdings. Unfortunately, it was an over-reach as the Q.E.P. Index turned up, indicating a decline in growth potential. Nevertheless, with the over-all market starting to recover from a recession, investors continued to price in additional earnings growth and the company finished 2002 on a strong note.

Year 2003: By the end of 2003 the *New York Times* was available in over 251 markets across the country, compared to 62 just five years prior, and the company acquired the remaining 50% ownership in the *International Herald Tribune*. In the fourth-quarter the company reported better-than-expected results and the share price ended the year at \$47, boosting the \$100 investment to a value of \$313, yet growth potential remained flat. *Value Line* expected “near-double-digit growth for 2004 with the shares having an above-average long-term appreciation potential.”

Year 2004: By the end of 2004 ad revenues were down and despite expansion of the national distribution of the *New York Times*, circulation declined 1%, primarily due to lower volume in the New York metro area. In reaction to this the company began to reduce headcount and growth potential, as measured by the Q.E.P. Index trend, took a major negative move. From there it was pretty much a straight line collapse of growth potential and share price despite increases in newspaper prices and the sale of 50% of its interest in the Discovery Times Channel and other assets.

Year 2006: By the end of 2006, the investment in NYT had declined to \$167, almost half what it was two years prior. Since the company continued to raise its dividend each year, *Value Line* stated that “those seeking good risk-adjusted 3-5 year total return” would find these shares attractive. The following year the Q.E.P. Index turned positive (declined) but it was not deemed a “buy” since it had reached a level where internal growth potential was unstable and the fundamentals were negative.

Year 2008: By the end of 2008 *Value Line* threw in the towel, stating “these shares offer limited upside potential in the coming months and rank unfavorably in the year ahead”. The investment value was \$33 by the end of the first quarter of 2009, a decline of 90% since the Q.E.P. Index turned negative.

D.R. HORTON INC. (DHI)

D. R. Horton Inc. (DHI) is engaged in the construction and sale of single-family homes in 40 markets in 23 states, including Mid-Atlantic, Midwestern, Southeastern, Southwestern and Western regions of the U.S. Homes range in size from 1,000 to 5,000 square feet, and in price from \$80,000 to \$600,000.

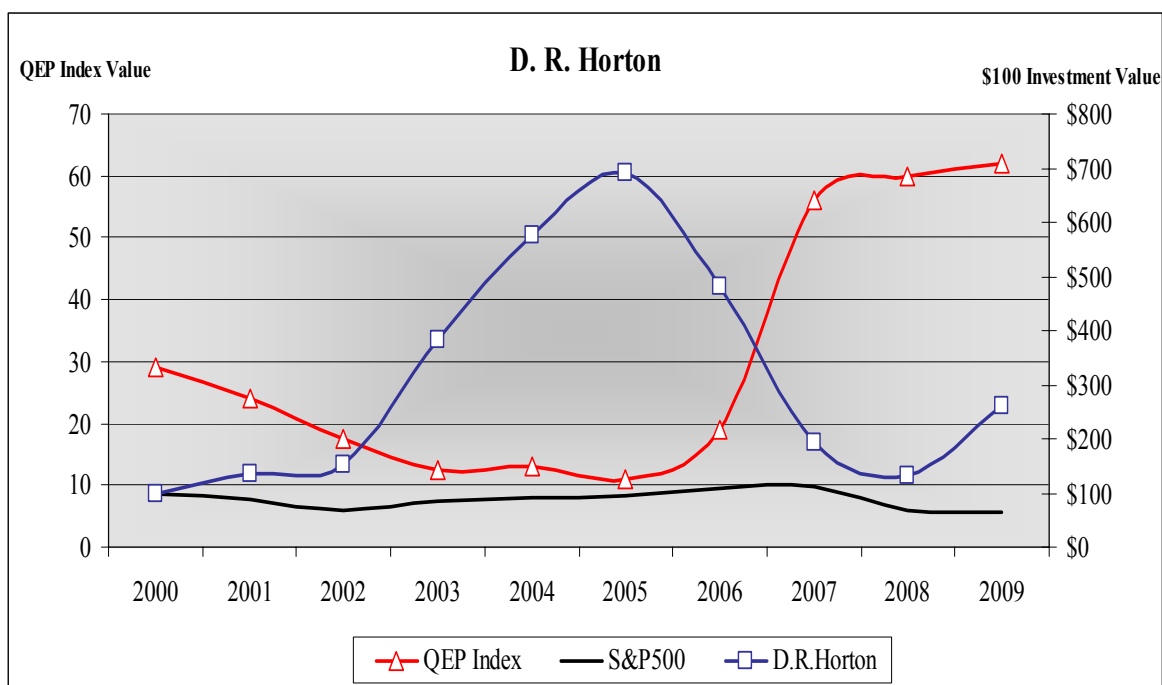
Year 2000: Internal growth potential, as measured by its Q.E.P. Index, was positive for DHI in 2000 (declining trend) as earnings grew 22% in the second quarter on a 5% increase in home deliveries and a 9% increase in average selling price (up 20% year-over-year). However, *Value Line* grew cautious as new orders and backlog were lower than in the prior year due to the Fed’s bias toward tightening of interest rates. But the company’s strong growth potential indicated little immediate downside risk. The following year, 2001, the positive trend in growth potential continued and expectations were for another strong year in 2002.

Year 2005: Over the next two years earnings grew and the company continued to add to its revenue base through acquisitions, having completed 17 in the last eight years. In the process the stock’s price rose at a faster pace than the over-all market and by 2005 it had increased almost 600% in

five years compared to a decline of 5% by the S&P500 Index. With this growth investors became more bullish on the stock and the value of the \$100 investment ended the year at \$692.

Year 2006: In the beginning of the first quarter of 2006 *Value Line* had written that it expected DHI to “get off to a flying start in fiscal 2006. This equity is a preferred choice in our momentum-driven Timelines Ranking System.” Unfortunately that did not happen. The trend in the Q.E.P Index in the first quarter of FYE 2006 indicated that growth potential had weakened and a “sell” signal was given. At that time the value of the \$100 investment had declined to \$673, a drop of 3% from its 2005 year end value.

What did happen in the first quarter was that inventories increased 18% sequentially and 35% year-over-year, while cash levels dropped significantly from the prior quarter to fund the inventory expansion. This caused the ratio of net homebuilding debt to total capital to increase, while at the same time homes closed for the quarter increased only 2% compared to the first quarter of the prior year and the average price of homes increased only 3%. The following quarter SG&A expenses as a



	Year Ended September 30									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	1Q09
D. R. Horton	\$100.00	\$134.62	\$153.85	\$384.62	\$576.92	\$692.31	\$480.77	\$192.31	\$132.69	\$261.54
S&P500Index	\$100.00	\$86.97	\$66.67	\$84.24	\$91.82	\$94.55	\$107.42	\$111.21	\$68.79	\$64.02

year and the average price of homes increased only 3%. The following quarter SG&A expenses as a percentage of revenues increased 90 basis points as additional employees were added to manage the higher inventory. As the year progressed, the rate of increase in earnings decelerated in relation to the increase in revenues. By the end of 2006 the negative trend in growth potential had steepened as an oversupply of homes available for sale created falling prices and margin erosion.

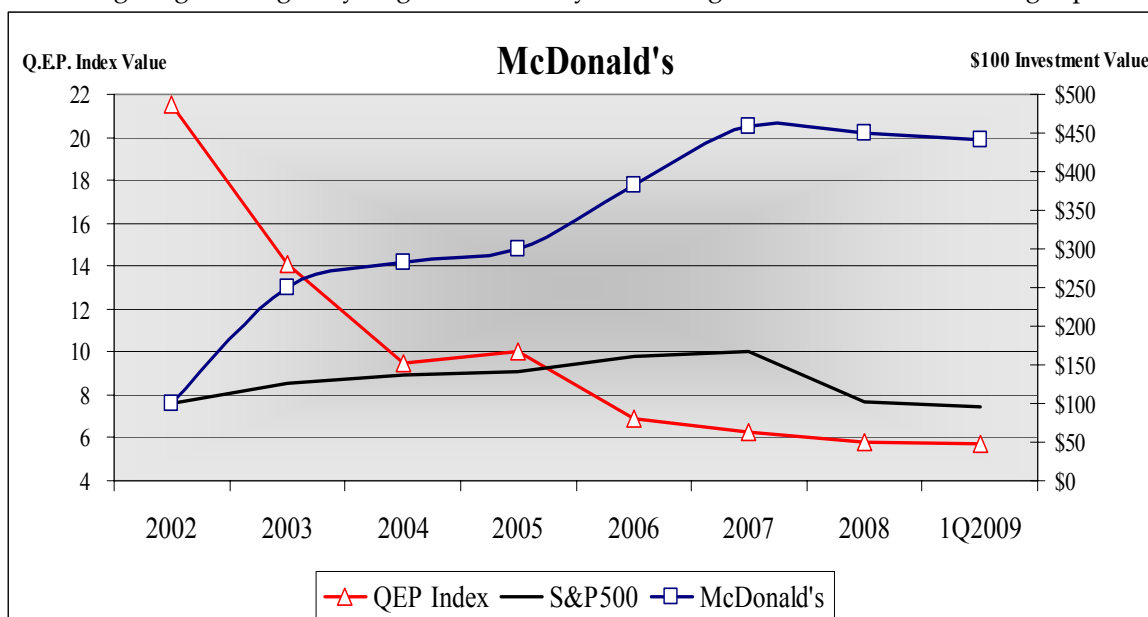
For the full year earnings fell 16%. Home purchase cancellations began to skyrocket, particularly in Florida and California. The cancellation rate rose to 40% in the final quarter of 2006, backlog dropped 6% and new contracts signed dropped 25%. *Value Line* lowered its 2007 earnings forecast by only 2%, but by then the value of the \$100 investment had dropped to \$481, a 29% decline since the sell signal was given in the first quarter.

Year 2008: Fiscal 2008 was another difficult year as heavy losses occurred from asset impairments and option contract write-offs. *Value Line* wrote "due to the company's large land holdings, hefty charges will continue over the next few quarters." With mounting operating losses and liquidity problems Moody's and Fitch lowered their ratings on DHI's debt instruments and DHI cut its dividend in half. Growth potential remained in a negative trend through the first quarter of 2009, but because of the past acquisitions the value of the company did not fall as steeply as the over-all market and has rebounded on speculation of a housing recovery.

MCDONALD'S CORP. (MCD)

McDonald's Corp.(MCD) operates or licenses nearly 29,000 fast-food restaurants in the U.S., Canada and overseas. In 2001 the company was hurt by weak global economies and unforeseen events (mad cow disease) in major European venues.

Year 2002: In 2002 the company announced several key organizational changes in an effort to improve customer-satisfaction ratings. *Value Line* wrote in March and December of that year that MCD was "untimely for the year ahead", yet the Q.E.P. Index trend moved strongly in a positive direction giving a strong "buy" signal. The catalyst was a significant decline in working capital as



	Year Ended December 31							
	2002	2003	2004	2005	2006	2007	2008	1Q09
McDonald's	\$100.00	\$250.00	\$283.33	\$300.00	\$383.33	\$458.33	\$450.00	\$441.67
S&P500Index	\$100.00	\$126.36	\$137.73	\$141.82	\$161.14	\$166.82	\$103.18	\$96.82

leverage was used to restructure its operations in four countries and close out three others, plus the elimination of 400-600 positions. Furthermore, the company elevated Jim Cantalupo to chairman and CEO and began installing a new system to improve customer service, food taste and variety. The most important change was the introduction of the premium salad line.

Year 2003: By 2003 same store sales were up 5% in the U.S., the first increase since 4Q2001. MCD began to respond to consumers becoming more health-conscious by introducing more fruit products as well as white-meat chicken nuggets. New hospitality standards and staff training focused on service improvements. The company also raised its dividend by 70% and repurchased stock to help increase shareholder value.

Year 2004: While growth potential flattened somewhat in 2004 the market continued to factor in the improvement, and by 2005 growth potential was turning more positive. However, by September *Value Line* wrote that "*the stock does not stand out either for short- or long-term performance*". Nevertheless, share price increased 6% for 2005 and 35% for 2006, on better-than-expected earnings and stronger sales while the S&P 500 increased 3% and 13%, respectively. Attractive product offerings and extended hours were the primary catalyst, but the company also divested Chipotle Mexican Grill. *Value Line* raised its near-term estimate but expected the shares to mirror the broader market for the year ahead.

Year 2007: With growth potential steadily improving, the stock's price increased 20% versus a 4% increase for the broader market in 2007.

Year 2008: By 2008, with foreign operations driving strong results, *Value Line* recommended MCD to conservative long-term accounts. While the broad market declined 38% in 2008 and another 7% for the first quarter of 2009, MCD's share price declined less than 4% for both periods.

SUMMARY

For most companies seeking growth there are only two options – make acquisitions or create new products. As these three examples illustrate, moving outside a company's realm of competence is often a detriment to advancing growth potential and shareholder value. NYT's strategy of acquiring the Boston RedSox and other non-related entities proved non-productive. The acquisition of related home builders by DHI proved to add value despite the major decline in housing. And for MCD, investment in new products and improved service related to their existing core business proved exceptionally beneficial even in a major market decline. As has been said before, it is a market of stocks and not a stock market.

PROCESS

1. Stocks are initially selected based on fundamental measurements of financial strength, profitability and cash flow. ROE \geq 14%; Cash ROE \geq 8%; Net Profit Margin \geq 4%.
2. Buy/Sell decisions are made from a quantitative model that measures the change in Earnings, Dividends and specific Balance Sheet items obtained each quarter from 10-Q and 10-K filings rather than 3rd party providers.
 - a. A positive change \geq 3% in the Q.E.P. Index signals a buy
 - b. A negative change \geq 9% in the Q.E.P. Index signals a sell.
3. However, a fundamental judgment overlay adds common sense to the buy/sell decision.
4. Although each company's quantitative model is updated each quarter and the decision process is repeated, each company is monitored during the quarter for news that may have a negative impact on prior financial data and cause a sell to be made (i.e., SEC investigation, merger or major acquisition, misleading information revealed, etc.).
5. Initial investment per stock is 1.5% to 2% of client's current account value.
6. For the Institutional LCG strategy the objective is to stay fully invested:
 - a. Stocks are trimmed at the end of a quarter when value exceeds 5%. Stocks are added to, if cash is available, at the end of a quarter when value becomes less than 1% of the total portfolio.
 - b. Cash holdings are kept to less than 5% and the average cash holding per quarter has been 2.7% for the past 8 years.
 - c. Average portfolio turnover for the past 8 years has been 64%.
 - d. Portfolio holdings range from 40-70 stocks.
7. The inter-mediate and long-term trend of an equity market is a function of the trend of internal growth potential for the individual companies that comprise that market. For the S&P500/*Select* strategy the objective is to default to cash when few stocks show positive growth potential, therefore this strategy tends to build cash (up to 30%) prior to a market decline due to the overall decline in growth potential, thus cushioning the downside risk. Conversely, cash is reduced (down to 5%) as it is re-allocated to equities after the market has established a new upward trend from stocks showing a positive change in growth potential.
8. For each strategy no leverage is used and stocks are not shorted.

ADVANTAGES:

1. Active strategy that provides an independent source of diversified alpha from an early entry into large cap stocks that are temporarily mispriced.
2. Quality of the stocks and the growth potential captured reduces volatility.
3. Quantitative accounting-model enhances discipline by lowering behavioral biases and constraining choices, and creates repeatable and consistent returns because:
 - a. It reflects a failure of the market to fully digest available accounting information.
 - b. It is useful in predicting growth potential relative to biased market forecast.
 - c. It is likely to involve a concentration of abnormal returns around subsequent earnings announcements.
4. Full transparency through Separately Managed Accounts.
5. Process is highly scalable
6. Primary custodian: Fidelity Investments

THE BEGINNING:

The **Q.E.P.** (Quantitative Earnings Power) **Index** was developed in 1992, outside the influence of Wall Street and the constraints of academia, as a quantitative method to measure the change in a company's internal growth potential. The Q.E.P. Index was first used to manage a personal IRA account. It was observed that a quarterly change in a company's Q.E.P. Index was soon followed by a change in its price, which meant that earnings and price projections made by traditional analysts for a specific company were sensitive to a change in internal growth potential as measured by that company's Q.E.P. Index. With analysts being slow to react to balance sheet changes, the Index served as a mechanical buy/sell signal to capture a stock's growth potential before the market could price it in or out. This created a more disciplined and efficient buy/sell process which avoided the influence of Wall Street and minimized the emotion of price changes.

Also, it was observed that the growth potential captured gave support to the stock's price in a market decline and enhanced it in a market upturn thus reducing volatility. In this manner the Q.E.P. Index created a competitive advantage over traditional methods of equity investing and the result was not only superior returns but superior *risk-adjusted* returns . . . thus a new pathway to alpha had begun.

The actual results of the management of the personal IRA portfolio are provided in the following table:

1992/Q3 to 1998/Q3		
	6-Yr. Total Return	6-Yr. Annualized Return
*IRA Account	213.92%	20.90%
S&P500 Index	149.14%	15.73%

*Source: RCB Trust Co.

THE MIDDLE GROUND:

To further test this unique approach, model portfolios were created for pension plan sponsors of Bell South and Georgia Pacific for Small Cap Growth and Large Cap Growth stocks. Stocks were chosen specifically from the S&P600 Index and the S&P500 Index from April 1993 through September 2000. The same stock selection process and buy/sell procedures were applied with the following results:

1993/Q1 to 2000/Q3		
	7.5 Yr. Total Return	7.5 Yr. Annualized Return
*S&P500/Select	534.0%	27.9%
**Russell 1000 Growth	283.2%	19.6%

1993/Q1 to 2000/Q3		
	7.5 Yr. Total Return	7.5 Yr. Annualized Return
*S&P600/Select	684.0%	31.6%
**Russell 2000	342.8%	21.9%

*Performance figures exclude dividends and fees

**Performance figures include dividends

THE LAUNCH:

Beacon Street Capital, LLC, was created in late 2001 with the launch of the DowJones/*Select* and S&P500/*Select* portfolios. The objective was to make available to

clients this hybrid form of equity management that could capture alpha on a consistent and repeatable basis with low volatility.

THE FIRM:

The firm is based in Atlanta and is majority owned by its principals who invest along with their clients in the same large-cap core and growth strategies.

A. Active Ownership: 92.96%

Terry E. Burke

CEO-Founder

Co-Portfolio Manager

Ownership: 49.21%

BSBA, University of Florida

35 Years of Experience

The firm is majority owned by the founders and not affiliated with any institutional organization.

Herron P. Weems

Managing Director-Founder

Co-Portfolio Manager

Ownership: 43.75%

BA, Vanderbilt University

MBA, University of Chicago

31 Years of Experience

The PMs have worked together since inception, 2001.

B. Passive Ownership: 7.04%

DISCLAIMER

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