

## A Value Fund With Values

**Talking With  
Josh and Adam Strauss**  
Portfolio Managers  
The Appleseed Fund

**By Karen Hube**

Josh and Adam Strauss can give you lots of reasons why companies with strong environmental and workplace policies will give investors outsized returns. But ultimately, the performance of their mutual fund—The Appleseed Fund—will make or break their case.

The fund (ticker: APPLX), which holds only companies that pass both a stringent value test and a sustainability screen that takes into account concerns such as human rights, not only is the top-ranked socially responsible fund over the past three years; it is also the top performer in the entire mid-cap-value stock category for the three years ending April 30.

Launched in December of 2006 by Pekin Singer Strauss Asset Management, a Chicago-based money manager with \$750 million under its care, the \$137 million fund is run by brothers Josh, 37 years old, and Adam, 40, as well as three other co-managers.

**Appleseed is an** anomaly in the universe of 85 nonreligious socially responsible funds. Most such funds look much like the Standard & Poor's 500 Index, minus the companies that don't meet their criteria. Appleseed is one of a few value-oriented socially responsible funds.

The Strauss brothers think of their fund as one that follows its own path. It has a compact portfolio whose stock holdings, which now number 22, typically range between 20 and 25. Each one must pass management's hurdles for valuation: "We only buy a stock at a price where

**Appleseed's Josh (left) and Adam Strauss** have stakes in everything from giant pharma stocks to nuts.

*(over please)*

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there is a 50% upside between the stock at its current price and our estimates of its intrinsic value," Adam says.

He continues: "If we think it's undervalued by 10% or 15%, we're going to take a pass, because there isn't a large amount of margin of safety for us."

Appleseed also looks for strong free cash flow, a sustainable dividend yield, and a tangible book value that's high relative to stock price.

Josh says they won't hesitate to dump a company—no matter how good its fundamentals—if it trips up on Appleseed's social-acceptability measures. For example, the fund had a stake in Cintas (CTAS), a uniform manufacturer with strong fundamentals, but dropped it in the first quarter of '09 after an employee's death raised questions about unsafe working conditions, Adam says.

The portfolio screens out companies in the businesses of tobacco, alcohol, pornography and weapons. It also has a scoring system that assesses companies' environmental and human-rights records. "We wouldn't do business with a company that has direct investment in Sudan, for instance," Adam says.

Even once a company passes the investment and social screens, it isn't a sure bet the portfolio will pick up its shares. "Four out of five managers have to agree before we invest in any company," Josh says. The other three managers on the fund are Josh and Adam's father, Ronald Strauss, plus Rick Singer and Bill Pekin.

**It's hard to tether** the fund to a Morningstar style box, because Appleseed doesn't care what a company's size is. "We dance up and down the spectrum," Josh says. "We aren't here to fit into a style box, we're here to protect on the downside and beat the S&P 500." While its second-largest holding is giant drug maker Pfizer (PFE), with a market cap of \$135 billion, its third-largest is micro-cap John B. Sanfilippo & Son (JBSS), a nut processor and distributor with a market cap of \$152 million.

Pfizer is a favorite due to its valuation. "We have a lot of upside opportunity and very little downside risk. And while we are waiting for the market to recognize this, we're getting paid a 4.2% dividend yield," Adam says. He applauds the company's October 2009, \$68 billion purchase of drug maker Wyeth. "We give man-

agement credit because they purchased Wyeth when investors were scared to do anything," Adam says. "They put their cash to use at a very reasonable price, and as a result, they have a much stronger pipeline."

Pfizer forecasts revenue of \$65.2 billion to \$67.7 billion for 2012, and the Wall Street consensus is \$62 billion. "We think it will be in between. Investors will generate a very attractive return with the stock, if it comes close to what the company predicts," Adam says. Pfizer's earnings per share in 2009 came to \$2.02. Appleseed expects them to reach \$2.18 in 2010, and \$2.29 in 2011.

Appleseed has held shares of John B. Sanfilippo since the fund's inception, and added to its position when the stock went down with most small-caps in 2008. "The stock price was below tangible book value, and it continues to be," Adam says. "If all you're paying for is the value of the company's hard assets, and the company is worth more than that, then we're thinking it's a great example of a strong risk-reward profile."

Last week, the company announced it would acquire Orchard Valley Harvest, a nut and dried fruit supplier, for \$29.5 million in cash. On this news, Adam has raised his earnings estimates by 25 cents. The firm's earnings per share were \$1.46 for the past 12 months through the first quarter this year, and he expects them to be \$1.65 for the next 12 months and \$1.60 for the following year.

Appleseed's second-biggest position is in gold, due to the managers' concern about inflation and the value of the dollar. "We view gold as portfolio insurance," says Adams.

Through both 2008 and 2009—years marked by wildly different market directions—Appleseed stayed a top performer. "Usually, people with high-quality portfolios in 2008 lagged in 2009, but their performance was strong," says Morningstar value-fund analyst Michael Breen. He considers the fund, with a less-than-average annual expense ratio of 1.2% and a low turnover rate of 41%, a strong core holding.

In 2008, while the average value fund was down 36.7% for the year and the S&P 500 was off 37%, Appleseed posted a loss of 18.1%, the best in the group. The strong relative performance continued through early 2009, when the stock

market was still in free fall. The fund was down 0.64% for the quarter, versus 11% for the S&P 500.

**One of the main reasons** the fund held up better than others is that it pulled out of almost all housing-related stocks starting in 2006, Josh says. Then, in September of 2007, after weeks of daily 6 a.m. meetings, the management team decided to sell "anything that might have hidden liabilities related to the housing market," he says. "Not being exposed to highly leveraged banks helped us," Josh says.

Despite the huge market shift in 2009, the fund maintained its performance lead: It was up 59.9%, compared to 33.9% for its category and 26.5% for the S&P 500. Its strong 2009 return was helped by a group of micro-cap stocks the fund bought early that year, such as ICT Group, an underperforming operator of global call centers based in Newton, Pa., which was bought by Sykes Enterprises early this year. Appleseed's gain on the stock in 2009: 257%. After ICT rebuffed a takeover offer early in 2009, its shares soared on the likelihood that it would be purchased.

Another high-flyer was Gaia (GAIA), a distributor of healthy, sustainable lifestyle-focused media and other products, which was up 67% in 2009. Appleseed did even better, however, since it acquired its first shares of Gaia near their low point in February: "Our return on the stock was 118% for the year," Josh says. Beaten down in the credit crunch, the stock took off as small-caps led the market in the second half of 2009.

So far this year, the fund hasn't performed as well. With a 4.02% return, it is lagging behind peers' average 12.15% through the end of April; the S&P is up 7.05%, according to Morningstar.

Adam notes the top market performers simply aren't the kinds of companies Appleseed favors: "This is a low-quality rally we're in. The lowest-quality companies are performing the best," Adam says. "We aren't going to chase rallies; we're sticking to our knitting." The fund is poised to snap up shares when opportunities arise; at 16%, cash levels are on the high end of the typical range.

Morningstar's Breen says this year's performance must be put in context. "For the trailing three years, they're still No. 1 in their group. They're good stockpickers," he says.

Pekin Singer Strauss has run socially responsible portfolios in separately managed accounts in the past, but Appleseed is its first foray into open-ended mutual funds. “The firm has been around for about 20 years, with a good long-term record,” Breen says.

Layering a socially responsible screen onto Pekin Singer’s value analyses stems in part from a belief that steering businesses to more environmentally sound and humane practices is the right thing to do. Both Josh and Adam say their shareholders agree.

Sustainability practices were a part of their careers prior to joining Pekin in 2004. “It’s in our DNA,” says Josh, who

was the director of business development at Color Kinetics, one of the early developers of energy-efficient lighting. Prior to that, he worked as an international trade consultant for four years, at law firm Shearman & Sterling, and as a consultant at valuation specialists Markowitz & McNaughton.

Adam was executive vice president of corporate development at EquipNet, which helps manufacturers redeploy surplus equipment. Beforehand, he was a vice president of business development at natural-food company Frontier Natural Brands. He started his career as a management consultant at Anderson Consulting and Gemini Management.

But Adam insists socially responsible investing also grows out of a conviction that it will help uncover the best long-term investments: “There is every indication that screening companies for sustainability adds, rather than detracts, from performance. We want managers who aren’t sacrificing durability for whatever their earnings per share are going to be next quarter.”

He adds: “We like managers who are thinking long term, and these tend to be managers who understand that managing your business to be sustainable makes sense,” Adam says.

But they also have to do well while doing good. ■

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Micro- and Small-Cap investing involve greater risk not associated with investing in more established companies, such as greater price volatility, business risk, less liquidity and increased competitive threat. On March 31, 2010, the Appleseed Fund owned an 11.2% position in Pfizer, a 5.1% position in John B. Sanfilippo, an 8.8% position in SPDR Gold Shares, a 0% position in ICT Group, a 0% position in Sykes Enterprises, and a 2.0% position in GaiaM. The S&P 500 Index is a widely recognized unmanaged index of equity prices and are representative of a broader market and range of securities than is found in the Fund's portfolio. The Index returns do not reflect the deduction of expenses, which have been deducted from the Fund's returns. The Index return assumes reinvestment of all distributions and does not reflect the deduction of taxes and fees. Individuals cannot invest directly in the Index, however, an individual can invest in exchange traded funds or other investment vehicles that attempt to track the performance of a benchmark index.

**Annualized Total Return (through 3/31/10)**

	1-Year	3-Year	Since Inception (12/8/06)
Appleseed Fund	65.9%	8.1%	9.0%
S&P 500 Index	49.7%	-4.2%	-3.3%

The gross expense ratio of the Fund is 2.09%, and the net expense ratio after contractual fee waivers is 1.31%. The advisor has contracted with the Fund to waive fees to maintain a 1.24% expense ratio (excluding indirect expenses) through January 31, 2011. There is no guarantee that this or any investment strategy will succeed; the strategy is not an indicator of future performance; and investment results may vary. For the three year period ending March 31, 2010, Appleseed Fund was the top performing mid-cap value fund and socially responsible domestic equity fund, out of 310 and 136 funds respectively, according to Morningstar. For the one year period ending March 31, 2010, Appleseed was ranked #15 out of 193 socially responsible domestic equity funds and #134 out of 360 mid-cap value funds.



**Appleseed contact:**  
 Christen Farrey  
 1-312-896-9660  
[christen@appleseedfund.com](mailto:christen@appleseedfund.com)  
[www.appleseedfund.com](http://www.appleseedfund.com)