

## Manager Performance

*Starting with the premise that the mutual fund industry does something wrong in searching for talent, the Marketocracy Masters 100 fund has decided to cast a broader net to find the people who can consistently beat the market. Reaching out to places not traditional for the mutual fund world, the company has built the technology platform to track members on the site who excel at trading and utilize the insights of the best ones. A diversified fund, it looks for the stock that can double in two years in many uncorrelated areas.*

**Q: What is the investment philosophy of your fund?**

**A:** We are active managers and if you look at statistics, only about 20% of the actively managed mutual funds beat the market. That number could lead to a conclusion that it's not worth investing in an actively managed fund because if you just buy the benchmark, you'll do better than 80% of the people who spend all their time trying to beat the benchmark. An equally valid conclusion is that mutual funds do a very poor job finding investment talent.

So our basic philosophy is that skilled investors do exist, but you have to look hard to find them. That means casting a broader net, not hiring just business school graduates or mutual fund professionals. I myself started out as a founder of a medical device company and I know that in the medical device business, there are many things that insiders understand and take for granted, but the Street doesn't really get.

Our idea is to find people with first-hand experience and use their insight to get to the heart of whether companies are going to succeed or not. The difficult part is that there are many people who know enough about their industry to make good investments, but there are very few people who have this level of expertise across enough industries to beat the market consistently.

To find them, you need to look at their long-term track records in great detail so that you can identify their strengths and weaknesses as investors. Then you need to manage them so that you can put together a portfolio that's diversified and still has the potential to outperform.

**Q: How exactly do you track the right people in the industry?**

**A:** It is very difficult to trace people's track records because the average tenure of a mutual fund manager is not long enough to assess his performance. Everyone in the industry tracks fund performance, not manager performance, and we find that useless.

That's why we created our website, where we allow anyone with web access to manage a model portfolio and to show, over a long enough period of time, that they can make decisions that do well. That's very different from Wall Street's approach, which is recruiting people based on a resume and an interview. Then they put them in training programs and then track their performance, while we do the tracking beforehand. Often they hire them right out of school, before they have any industry experience.

We believe that business schools aren't the only place where investment talent resides, so we cast a broader net and let the track records be the first screen.



**KEN KAM** is the CEO and founder of Marketocracy, Inc. and Marketocracy Capital Management LLC. Marketocracy Capital Management is the registered investment advisory firm that manages the Masters 100 Fund (MOFQX).

Ken founded Marketocracy to recruit a large team of portfolio managers with expertise and a passion for investing. His mission is to find the best investors in the world and then track, analyze, and evaluate their trading activity. Prior to Marketocracy, Ken was the co-founder and CEO of Firsthand Funds and the co-portfolio manager of the Firsthand Technology Value Fund which was ranked as the #1 fund of all mutual funds in the country for the 5 year period ending September, 1999.

Ken has over 20 years of investment experience and holds a B.S. degree in Finance from Santa Clara University and an M.B.A. from Stanford University.

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We do follow-up with interviews only the people who produce good track records.

**Q: Have you found any fund managers using this approach? How many people are on the site that way?**

**A:** There have been over 80,000 people and 100,000 portfolios or funds started this way. Most people find out quickly that they are not very good at it. Right now I believe that we have 30,000 active portfolios. We are just coming up to our fifth birthday and there are people who are distinguishing themselves enough as the people we should be hiring.

I think that anybody in the industry who wants to manage money for a living should own his personal track record. Marketocracy sites have been a way for a lot of people to maintain their own personal track records. As these track records get older and more seasoned, they are going to become more valuable for employers.

**Q: How does that philosophy translate into an investment strategy and process?**

**A:** A lot of statistics on Wall Street is based on looking at what the ‘smart money’ is doing. They define ‘smart money’ as institutional money but we define ‘smart money’ as the people with the best track records. If you have a good way to know what the people with the best track records are doing, then you ought to look at where their portfolios are weighted, and what stocks they are buying and selling. When I see them doing something that is opposite of what

Wall Street is talking about, that is something that warrants our attention.

The list of stocks that the top guys hold in their portfolios is a rich source of ideas for research. But it’s hard to come up with 50 great ideas; everybody follows a list of 20 to 50 stocks and maybe only one or two of those ideas are worth putting more money into.

When you look at the bigger positions in the best guys’ portfolios and think about the possible triggers for the stock price, you’ll see that only a few issues are powerful enough to drive the stock price. Once you know what the questions are, you can discuss them with the community. Even the investors without great track records may have the answer to that question, or can at least provide their own perspective that can help one of the top guys make a better judgment.

So our strategy can be described as a way of surrounding the company. First you got to ask the right questions, and then you have got to put the questions in front of the right people.

For example, we have thousands of people on our site who have included biotech companies in their model portfolios. Although many of those people don’t have great overall track records, if you are interested in a specific drug or a company, this is the group of people from whom you will get thoughtful responses on the main issue that is likely to determine if the stock will double in the next year.

We start looking for stock candidates by looking in the portfolios of the very best investors and we try to find out what are the few things that have to go right for those stocks to double. Then, we put those questions to everybody else in the community that has owned that stock. Out of that interaction, as a group, we make better decisions than the managers who would make them on their own. That is a research process that we started about a year ago and we have only done this for about a half of dozen stocks.

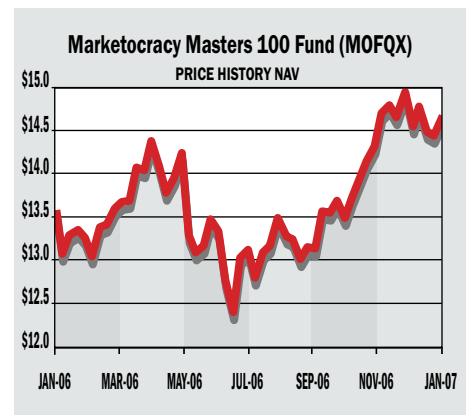
**Q: What’s your strategy in terms of diversifying and building the portfolio?**

**A:** We are trying to beat the market with a diversified portfolio and this is very difficult. Most active managers beat the market by focusing and taking larger risks. They focus in an area where they have some industry expertise that helps them to do better than average. But when you start to run a very narrow portfolio, by definition, you have a more volatile portfolio. We, on the other hand, have so much talent that we are not limited to any single sector or trend. In fact, I like it better when drivers behind the stocks are independent of each other, even if they are going in opposite ways.

Overall, every stock in the portfolio has to have a good reason to be there on its own. We don’t add any stock just to get diversification. If we don’t have a strong case that it can double in two years, then it doesn’t deserve a big position. The ideal portfolio is a set of best-idea stocks that collectively are in more than one sector and are dependent on different factors. That’s how we bring diversification and still maintain the potential for great returns.

**Q: How many stocks do you have in the fund?**

**A:** We have 250 stocks right now. We are going through this process of looking at the big holdings to see whether they warrant being big or bigger holdings. As we work through the list, we are willing to make bigger bets on the best ideas and there’ll be fewer holdings. But I’d



be surprised if we ever got down to less than 100 stocks.

**Q: What is your view of big positions?**

**A:** Any stock that is more than 5% of the portfolio is a big position. One investor, whom I have been tracking for almost six years, has 27 positions in his portfolio right now. He has probably had over 100 positions over the last six years and he has made many buy and sell decisions.

Of all of the stocks that this investor has ever touched in his portfolio, 79% made money 21% lost money. The ratio between the average loss and the average gain tells you how well he is doing cutting off his losses, and the ratio for this investor is two. This means that when he picks a stock that turns out to be a winner, he makes twice the money he loses on a stock that turns out to be a loser. And he has a lot more winners than losers.

So, we are betting on an investor with a great track record. When he picks a stock, especially one that he chooses to make a large part of his portfolio, then we put it out to the broader community to see if we can flush out the idea and help him to either have more conviction on this stock or to clear some issues so that he can get out with a smaller loss.

When you have investors like that, there are many stocks that are candidates to become 5% of the portfolio just on the strength of conviction. But, I would not let any stock become a big position unless we have conviction from a more extensive research process that involves tapping the broader Marketocracy community.

A large number of the stocks in our portfolio are very small positions where we are using the judgment of these investors. There are about eight to ten positions that are big enough after we put them through the whole research process.

**Q: What is your view on risks and how do you mitigate them?**

**A:** The industry usually defines risk as the volatility of the portfolio or the tracking error. I think of risk as the various factors that drive the doubles in each of these companies, and as a list of factors that would be disasters for these companies.

Risk control is, first of all, making sure there is no single risk that affects all the stocks in your portfolio. It's not a volatility argument but an assessment about what conditions in which the portfolio does well or poorly, and making sure that your portfolio is constructed such that there is no single factor that can knock down all the positions. The more diversified the portfolio is across different driving factors, the better I feel.

For example, right now, people are worried that the energy level is topping. Many people are trying to get out before the rest, and that's making oil stocks weak. I think there is a real risk, but the very best people are actually buying more of the refining stocks. I'm willing to follow their lead but only up to a degree, because I don't want the whole portfolio to come falling apart should oil tank. I am keeping the energy sector less than 25% of our portfolio.

So, although we would have some great investments in the energy, unlike an energy fund, which must invest in energy our portfolio could do well even in the disaster oil scenario. Although we have some biotech stocks, we buy them because we like the drugs they are launching. These are not sector bets but are company bets. The important thing is that the returns are going to be independent of the industry.

There are four or five areas where there are active bets that would do very well if everything worked out well. I'm not betting that we are going to be right on everything. In fact, I'm sure that we are going to be wrong on some things. But because of our research process, I'm confident that our portfolio is going to be more right than wrong. **T**

## Marketocracy Masters 100 Fund

### FUND FACTS

Symbol	MOFQX
Website	<a href="http://funds.marketocracy.com">http://funds.marketocracy.com</a>
Address	Marketocracy Funds 1200 Park Place, Suite 100 San Mateo, CA 94403
Tel. No.	(888) 884-8482
Inception	11/05/01

### PORTFOLIO

Total Net Assets *	\$ 44.0
Avg Mkt Cap (\$ Weighted) *	\$ 16,300
Average Price/Earnings Ratio	14.38x
Average Price/Book Ratio	4.67x
Turnover Ratio	156 %

### INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$ 2,000
Min Subsequent Investment	\$ 50
Min Initial IRA Investment	N/A

### RISK (S&P 500)

Alpha	- 0.79
Beta	1.71
R-Squared	0.54
Ann Std Deviation	15.73
Sharpe Ratio	0.36

### RETURNS VS. LIPPER SIM-CAP CORE IX INDEX

	MOFQX	Index
1 Year (Cum.)	6.77 %	7.54 %
3 Year (Ann.)	4.83 %	12.61 %
5 Year (Ann.)	10.20 %	11.16 %

### RETURNS VS. S&P 500

	MOFQX	Index
1 Year (Cum.)	6.77 %	14.51 %
3 Year (Ann.)	4.83 %	10.32 %
5 Year (Ann.)	10.20 %	6.82 %

### FEES AND EXPENSES

Max Sales Charge - Front	0.00 %
Max Sales Charge - Deferred	0.00 %
Max Redemption Fee	0.00 %
Total Expense Ratio	1.95 %

### PORTFOLIO MANAGER

Ken Kam	11/05/2001
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\* millions

Data through: 12/31/06

Source: Company Documents; Lipper

**Ticker staff searches for mutual funds for their consistency in performance and durability of investment style.**

**Our interview covers investment philosophy and strategy, research process, portfolio construction and risk control for funds. Through an interview we uncover long-term strategies and processes that help to generate long-term returns.**

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