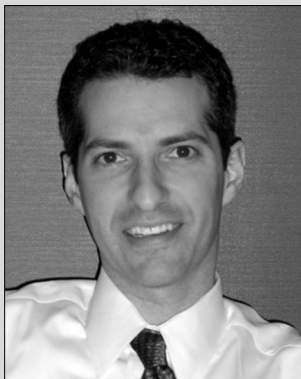


THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Customized Portfolio Management



STEVEN SHELDON, Founder of SMS Capital Management, LLC, has over 15 years of professional financial and investment experience. Prior to founding SMS Capital Management, Mr. Sheldon evaluated corporate investments for Enron where he managed a portfolio of private and public holdings in the energy and telecommunications sectors. He was also a corporate banker with The Fuji Bank, Ltd., and a commercial lending officer with Texas Commerce Bank (now JPMorgan Chase Bank). Mr. Sheldon graduated from The University of Texas at Austin with a BBA in Finance and earned an MBA (with honors) from Tulane University's A.B. Freeman School of Business. He is a Chartered Financial Analyst and a member of both the CFA Institute and the Houston Society of Financial Analysts. He also serves as Vice President of the MBA Council of Houston.

TWST: Would you begin with an overview of the firm and what your responsibilities are there?

Mr. Sheldon: SMS Capital Management is an independent investment management and financial advisory firm based in Houston. We serve the needs of individual investors, and because we are a boutique firm, our philosophy is centered on customization of client portfolios to meet the unique needs and objectives of each client. I am the Principal of the firm and Portfolio Manager.

TWST: Does the firm have an overall investment philosophy?

Mr. Sheldon: Yes. As a firm we have two investment strategies or approaches available to our clients. One involves constructing and actively managing diversified portfolios comprised of core and alternative asset classes, where over time we make gradual shifts to those asset classes, and some tactical plays, depending on our forecast for different asset classes. In this approach we use a combination of exchanged traded funds (ETFs), index and actively managed funds, and, to a lesser degree, individual securities.

The other approach that is available to our clients takes the form of a private investment fund. This fund, unlike the other approach, holds a concentrated portfolio of individual securities and uses a "go anywhere" investment style. We look for value plays and

growth-at-a-reasonable price oriented investments to achieve more absolute returns that aren't necessarily correlated with the performance of the S&P 500. This approach also uses options to enhance returns over time.

TWST: Who are your typical customers? Are they mostly high net worth individuals?

Mr. Sheldon: Our clients include high net worth individuals and high income earners. Portfolios we manage range anywhere from \$100,000 to several million.

TWST: Tell us about the customization of the portfolios according to each client's needs.

Mr. Sheldon: At the beginning of a client relationship, we sit down with that client and go through their investment history, investment time horizon, particular objectives, risk tolerances, and any unique circumstances that may have an impact on their investment objectives. Then we use that to build a portfolio that suits their particular needs. For example, if we have a client who is an executive in an energy company and that person has a tremendous amount of financial exposure to that industry sector, then we will seek to potentially lessen or adjust that exposure in their investment portfolio. We don't want to double down or be redundant with what they personally have at stake.

TWST: So the first step would be meeting the clients and discussing what they need and what you can provide. Is asset allocation the next step?

Mr. Sheldon: Yes, we would be talking with them and understanding what their needs are, and then coming back with a recommended asset allocation, given their profile.

TWST: Tell us about your asset allocation process.

Mr. Sheldon: We determine a target asset allocation for each client, then make adjustments as necessary. For example, in a moderate growth portfolio, a target level may be 70% equity and 30% bonds or fixed income. Over time, we will make gradual strategic and tactical shifts to those levels, depending on our outlook for those asset classes.

On the fixed income side, we have been underweight for the last two years and just over the last three months, we have gotten

economic growth, and corporate profits heading. Then, we make a determination as to what types of investments or asset classes we think will thrive or outperform, given our outlook. For example, last year and again this year, our forecast was for a relatively flat market with nothing exciting in terms of equity returns. So we looked for types of investments or strategies that would perform well in that type of environment. We decided that a covered-call strategy made sense for a portion of clients' equity exposure. This strategy, which involves owning stocks and writing call options on them, delivers enhanced equity returns in a flat or potentially down market, but will underperform in a rapidly rising market. Instead of buying a bunch of individual securities and writing calls on them, we looked for different vehicles that could accomplish that for us, and we found a couple of different closed-end, covered-call funds with good management that were selling at attractive valuations and picked those up for clients.

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close to our target levels. We believe that we are very close, if not already finished with the interest rate increase cycle. Within fixed income, we are currently more concentrated on the very high quality US government Treasury bonds of short- to medium-term duration. We want to be positioned for when the Fed starts cutting rates potentially later this year or early next year, and those shorter duration securities stand to benefit. Long-term rates may stay elevated or even rise, making them less attractive. On the equity side, if the target level is 70%, we are about 7% underweight as we believe we will see a deceleration of earnings growth as the economy clearly shows signs of cooling. Even though there has been some enthusiasm for the end of rate hikes, and we have seen recent little jumps in the market, we haven't seen real pessimism manifest itself and the significant market declines that may be associated with decelerating earnings growth. Our expectation is that may happen in the next few months during the seasonally weak period of the US equity markets. If a deeper correction unfolds, we intend to bring the equity levels back up to target levels, or even overweight equities if valuations get attractive enough.

TWST: Do you do macroeconomic analysis as part of your asset allocation process?

Mr. Sheldon: We certainly do monitor the US and global economies, and form an opinion based on where we see interest rates,

TWST: What are your views on the diversification of portfolios?

Mr. Sheldon: We believe that some level of diversification is appropriate for all clients. Where we are a little bit different from other firms is that we don't want to add an asset class or overweight an asset class in a portfolio, unless we feel the risk/return profile warrants that position. Two examples would be emerging markets and energy. Those areas have obviously been very hot over the last couple of years. We believe that our clients already have an acceptable level of energy exposure since some of the broad-based market and actively managed mutual funds we use already have energy positions. Likewise, some of the international funds that we would use have some emerging market exposure. We wouldn't go and add 5% to 10% of a client's portfolio in emerging markets or energy at this point just for the sake of diversification, since we feel that is exposing our clients to undue risk at this point in the economic cycle.

TWST: But you do have them as alternative choices when the market so requires?

Mr. Sheldon: Exactly. We added concentrated exposure to some energy funds about two years ago and enjoyed a nice return. Then we decided to sell those funds last year because we thought that the money had been made and we were now at a point in the cycle where we did not find that continued exposure appealing.

An example of an area where we are currently overweight is Japan. We believe that adding a specific Japan fund to client portfolios was warranted last year. We liked the longer term, say three- to five-year outlook for the Japanese economy, and the lower historical correlation with US equity markets, so that is a hold for us at this point. That is an example of a specific alternative or tactical strategy that we use for client portfolios.

rural towns and cities in the US. Their stock prices had declined significantly on some bad news and the yields were 10% plus. Based on our homework, we thought it was a good buying opportunity, with limited downside risk and good near-term return potential. We picked up a basket of these companies to limit our risk. That was an opportunistic value-oriented investment and those have done very well this year, and we have already exited most of those positions.

“Within fixed income, we are currently more concentrated on the very high quality US government Treasury bonds of short- to medium-term duration. We want to be positioned for when the Fed starts cutting rates potentially later this year or early next year, and those shorter duration securities stand to benefit.”

TWST: Tell us about your approach to ETFs in the portfolio.

Mr. Sheldon: ETFs are a low cost, flexible mechanism or investment vehicle to get clients either broad-based or concentrated exposure to a particular area or asset class. We use a combination of ETFs, depending on the client’s situation, to gain exposure to the market or specific area.

TWST: Would you tell us about the SMS Index Plus approach?

Mr. Sheldon: Index Plus is using a combination of index-oriented investment vehicles to gain broad market exposure and then layering on actively managed mutual funds, and some tactical plays in sectors or asset classes, and to a small degree individual securities. By building a portfolio this way, the idea is to try to get market or better than market returns with less risk.

TWST: How do you select your individual securities for holdings?

Mr. Sheldon: Again, individual securities play a big part in our private investment fund and a relatively small part in the diversified portfolio strategy. When selecting individual securities, we look for undervalued securities across a broad spectrum — kind of a “go-anywhere” approach regardless of the capitalization structure or geographic location. We look for a value oriented investment that is selling at a discount to its intrinsic value or offers growth at a reasonable price.

TWST: So your equity approach is generally value oriented?

Mr. Sheldon: Yes, it is very value oriented. That could be either on the equity side or could be on the fixed income side or something in between. For example, at the end of 2005, we evaluated RLECs. These companies are telecommunication carriers that serve

TWST: What about your risk management techniques?

Mr. Sheldon: We constantly monitor the exposure to different asset classes and positions within each client’s portfolio. If we believe an asset class is becoming increasingly risky and the risk/return potential is no longer attractive, we will make a change, usually gradually. An example is our recent moves to harvest some gains from small caps and reinvest in larger cap funds. Larger caps have not had the returns that smaller caps have enjoyed over the last several years. Their valuations and return potential, we feel, is more attractive at this point in the business cycle.

TWST: How do you measure the performance of your portfolios? Do you have different benchmarks for the fixed income equities and so forth?

Mr. Sheldon: We present an internally generated benchmark for each client. For example, for a moderate growth portfolio of 70% stocks and 30% bonds or fixed income, we will measure that against a 70% S&P 500 and 30% Lehman Bond aggregate for a reasonable benchmark to use for that type of asset allocation.

TWST: What is your performance record? Have you been doing well in this type of market?

Mr. Sheldon: We have been doing well. Since we had exposure in client portfolios to areas that have outperformed, we have beat our benchmarks over the last few years. As a result, we have been able to add to returns without taking excess risk.

TWST: Tell us about the cash side. Do you like to keep a cash reserve in each portfolio or is that the decision of the client?

Mr. Sheldon: Some clients like to maintain their cash reserve in their portfolio rather than in a bank or CD. We also view cash as an asset class and will maintain cash balances if appropriate given our outlook for fixed income and equities. At the moment, most clients’ portfolios are 5% to 10% in cash, but that is by design. We have not liked

the fixed income risk/reward potential until now and have recently become almost fully invested. We are still cautious on the equity side. So we are maintaining some cash in the event of a deepening of the correction that we saw in the May and June time frame, as it would represent a good buying opportunity. It is more a question of what the outlook is, depending on how much cash we are going to maintain.

TWST: What do you think differentiates your investment approach at SMS from that at other firms that are providing customized portfolios?

Mr. Sheldon: What sets us apart is our active management and desire to seek out different types of investments, which work to grow and preserve our clients' portfolios regardless of the type of market we are in. This differs from some more traditional financial advisory firms that stick to a set allocation regardless of the market environment.

TWST: Looking out ahead for the rest of this year, do you see any potential problems or challenges that you might face in the market or in your type of investment?

Mr. Sheldon: I do think that the equity markets are susceptible to a further pullback as they digest the prospects of slowing earnings growth. We have not had a greater than 10% correction for several years now, not to mention heightened geopolitical risks. That is why we are cautious on the equity side and are making more defensive moves. We are opportunistic though and should we see a further pullback, we intend to get more aggressive on the equity side going into next year, which we believe should be a pretty good year.

Over the last two years, we have been seeing multiple contraction in the equity markets. We think that there will be catalysts next year to reignite multiple expansion, including the coming and going of mid-term elections and clarity that the Fed has indeed stopped or halted their interest rate hiking activity.

Another trend that we have monitored is the building of money market balances as a percent of total mutual fund holdings. We see the building of cash balances as a positive for next year if that money decides that it wants to move its way back into the equity markets. That would provide some additional fuel for an accelerating stock market next year.

TWST: How does the volatility in the market impact your investment?

Mr. Sheldon: We like to take advantage of volatility. If we see downside volatility, we are going to evaluate investments, sectors or areas that have been beaten down. On the other hand, if there has been upside volatility to the point where an investment has reached its potential, we will harvest gains and redeploy capital elsewhere. Since we are a boutique firm, we are nimble enough to use that opportunistic approach.

TWST: With individual clients, is tax efficiency an important consideration for your portfolio management?

Mr. Sheldon: Tax efficiency is an important consideration. We have the two strategies. With our diversified portfolio approach, we aim to be more tax efficient as opposed to our private fund of concentrated individual securities, where tax efficiency is not going to be the number one criteria — it is second to absolute returns. We are strategic about where we place specific types of investments. If a client has a tax deferred vehicle — for example, an IRA versus a taxable account — we would look to place investments that have either higher turnover or generate taxable income in the tax deferred account.

TWST: What advice would you give to investors looking to enter the market? What are the advantages of having customized portfolio management?

Mr. Sheldon: For starters, it is important if you are not an experienced investor to get some type of assistance. Too often, inexperienced investors base their asset allocations or their investment selections on what the best returns have been in the last few years. That is a major mistake since what has been hot the last few years may not continue to deliver going forward. You buy high, hoping things go higher as opposed to doing the opposite, which is harvesting gains from areas that have done exceptionally well and reinvesting in areas that stand to have their day in the sun over the next several years. So, in short, don't chase returns and try to stay disciplined and diversified. I like to say that, not unlike clothing styles, investment trends come and go over time. So sometimes it's better to buy what's out of fashion today because at some point it will be back in fashion.

TWST: Thank you.

Note: Opinions and recommendations are as of 8/15/06.

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