

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Customized Financial Planning & Asset Management



JOHN G. ULLMAN is Founder and President of John G. Ullman & Associates, Inc., a comprehensive financial management firm celebrating its 28th year. Mr. Ullman holds a Bachelor's degree with a concentration in Economics from Johns Hopkins University and an MBA in Financial Management from the University of Chicago. Recent honors include the John G. Eberenz Award for excellence in business in 2005, the Corning Rotary Club Paul Harris Fellow award in 1998, induction in the WC Mephram High School Who's Who in 1998 and the Small Business Person of the Year for 1997 by the Greater Corning Area Chamber of Commerce. Mr. Ullman joined Corning Incorporated in 1972 in Acquisitions and Corporate Business Development — where he held five positions in three divisions within five years. At the age of 30, he left Corning to pursue his personal dream of offering comprehensive financial management services, based

on trust, ethics, values and an extraordinary commitment to each client. He has witnessed his business grow consistently from \$1 million in managed assets in 1979 to the firm's current level of 950 clients and assets under management in excess of \$550 million.

(ZBK502) TWST: Would you start with a brief overview of John G. Ullman & Associates and its investment philosophy?

Mr. Ullman: Our firm is set up as a comprehensive financial management company, which combines customized financial planning and integrates it with individual asset management. The concept was something I was always doing, even at a very young age. The idea of being the family business manager, someone who could be found in one place with the highest ethical standards and no conflicts of interest, who would, by and large, take care of not only the strategies but the implementation as well was extremely important to me. Our approach here at Ullman from 1978 to date has been precisely that. While there's more technology now, and we've added people over all those years, the concept is really pretty straightforward. We'll get involved in very sophisticated planning matters like buying and selling of properties and businesses and executive compensation package negotiations. We get involved with the smaller details of life like forwarding beneficiary changes for life insurance and pensions and shopping the insurance. We do this while doing all the asset management.

We do the research in-house. As a balanced portfolio manager, we have as a requirement that the accounts be balanced. We want to be the family asset manager. We have minimum amounts that are in conservative investments, typically bonds. The equities are focused in different sectors. Using individual securities, each account is customized to fit the client's objectives. There are a number of themes that are part of our asset management approach.

We are approaching 50 employees. Our main office is in Corning, New York; we have a branch in Rhinebeck, New York; we have an affiliate in Rochester, New York; and some of our key employees with two-career families have relocated and are working for us in California, Florida, and Pennsylvania. We manage considerably in excess of \$550 million in total assets. We complete about 1000 tax returns a year. We have approaching 950 client families. We have very close relationships with our clients that are, for the most part, extremely long term. Our growth has been almost exclusively by referral — people relocate, and they have friends and family, etc.

TWST: What is the environment like for your type of investing? What are your views on stocks and on bonds at this time?

Mr. Ullman: Let me take bonds first because it seems particularly clear in terms of probabilities. Our bond portfolios have been for a while — and continue to be — in our most conservative position in our 27-and-a-quarter-year history. Our average maturities are less than two years. Except in a few instances where a new client owns one, we have essentially zero junk bonds in client accounts. Now, this is not the strategy that we want to have all the time. But I think the risk/reward ratios indicate to us that current interest rates are more likely to continue higher with a smaller possibility that they could go considerably higher. It's been fascinating to note that longer-term rates have really not gone up very much. We have a pretty flat yield curve, and the risk levels of going out longer term or going for lower-grade bonds with the very small risk premiums that are available just don't seem like an attractive place to be. So our accounts, in terms of the bond portfolios, are extremely high quality and short term. We're hoping that there will be a more favorable environment somewhere down the road that will allow us to have the normal variety that you would expect in a bond portfolio.

are doing things that are in efficiency-oriented technologies, not necessarily innovations for brand-new exciting areas. That's because I think the economy is under a reasonable amount of financial pressure right now, and the companies that can do things that are more cost-effective are going to get a heavy dose of interest from people.

On the healthcare side, we have some subsectors including biotechnology, and certain well-positioned pharmaceuticals in the proprietary grouping. There are some specialty equipment and service suppliers that we have in that area as well.

The infrastructure side — roads, bridges, tunnels, water, certain types of construction and telecommunications, for example — may not be as glamorous as some other fields, but it has been underutilized. Although we're seeing a lot more construction potential on the energy side, there are a lot of infrastructure areas that really haven't had much attention paid to them — water supplies and other things that just have gotten lower priority.

In the value-based sector, companies really widely vary. We haven't done much in this part recently, but some of the financial companies, for example, would have been in the value-based group in the past. In areas that are contrarian, we haven't done anything in the airline group. It just seems to us that it's been widely overdone.

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TWST: What type of stocks do you look for?

Mr. Ullman: We're sector-based. We do, however, individualize the accounts, using individual securities. The sectors that we have been focusing on for a period of time — and there have been some changes in focus — are in a number of areas. First is technology; then some sub-sectors in health care; the third would be infrastructure; then a sector that's value-based (a wide variety of companies that look to us to be undervalued or to have some potentially special opportunities, regardless of field); and foreign markets. Many of the companies in the portfolios are multinational, as might be expected, but we are using closed-end funds in certain countries as a supplement to that. Our investments are essentially, in terms of high-quality and speculative growth-oriented investments, in these five sectors.

In terms of technology, it's pretty widely diversified. There are many smaller positions that we hold, and they are in certain parts of the technology grouping. Our emphasis now is on companies that

However, we've been looking for the equivalent of an index fund for airlines because we don't know which ones are going to do better. Looking at **US Airways (LCC)**, it's up 60% in just a couple of months, and I think there will be other opportunities, but we haven't participated. I do view that grouping as being in the value-based area because it has had such a tough time.

A group we're presently looking at is affluent seniors. With the aging of our society and the demographics changing, it sure seems to us that there's a group of people who are coming into their retirement years who are going to have significant amounts of disposable income and wealth, and they're going to be looking to travel and use certain types of products and services. We're looking into that.

Another sector we're investigating is alternative energy, which could fall into technology or the value-based groupings, depending on the individual company. So those groupings plus foreign would be the areas we invest in.

TWST: Would you give us an overview of your investment considerations?

Mr. Ullman: America is a very industrious and innovative society, and we seem to always adapt to problems, though maybe it seems like it takes too long. We currently have, as always — though they vary from time to time — a variety of them facing this country. The problems on the plate now include (not in any particular order) absolutely huge and unsustainable, in my view, federal deficits. Our system is even more out of control than it has been in the past. There's just no discipline to speak of between revenues and expenditures — and that's regardless of party. I think as a nation we ought to be ashamed of ourselves for having gotten ourselves into this position. We need to either tax ourselves more to pay for what we're doing or spend less if we're going to keep revenues the same, but we can't continue to have the kind of deficit that has evolved. That's a

And the Iraq War has its own set of problems. Regardless of one's politics, the expenditure levels have been enormous, and the impact on our country, how it's viewed in other parts of the world, has been dramatically influential, sometimes positively and often negatively.

One concern I have that I hope doesn't come to fruition is that real estate ratios — what percentage of income an average person's mortgage payment, including taxes and insurance, represents — having been so strong for such a long period of time, have been materially increasing in certain parts of the country, particularly on residential housing. That's partly being fueled by the increase in housing prices and people's ability to upscale from one house to the other. But people are highly leveraged, and if, in fact, we were to have a decline, or much less liquidity in housing, that could have some dangerous consequences. I hope that's not a huge risk, but it's certainly one that we need to pay attention to.

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major national problem. Related to that is the trade deficit. With manufacturing being exported and many goods coming from the less developed countries — more and more from China and India — the deficits on trade have certainly been widening. In recent times, the energy problems and shortfalls have only exacerbated that — and ultimately, if one believes in equilibrium, the US dollar, which has held its own in recent months, would seem pretty likely to be further devalued as long as these trade deficits keep on mounting. That has major implications for foreign investment and also for interest rates in this country. If there's a view that the dollar is going to experience a renewed weakening versus other currencies, interest rates could easily trend very considerably higher, which will only exacerbate some other problems that we have.

Interestingly enough, we're rapidly approaching the baby-boomers-in-retirement years, and the needs for health care and government services are going to profoundly increase. On the good news side, I think there are a lot of very exciting developments in medicine. It would seem that there's a good chance, unless we have some catastrophic situation come in that does something horrible, that life expectancies are likely to be increasing and that means the demands on services and health care and extra kinds of support are bound to increase.

I spoke earlier of interest rates. If they do increase significantly, that's going to take away a lot of funds that would have been spent in the general economy.

Finally, on the positive side is simply the creativity of Americans in trying to find ways out of problems when we set our minds to it. It's a matter of there being enough urgency in certain areas. But this country has been more than remarkable in working through problems that have seemed insurmountable. So the problems today are different from those that might have been out there five or ten years ago, and they're pretty daunting. But I have the underlying confidence that we'll work our way through it, even though some of these problems look like they're really quite severe.

As a result, we are more targeted in investment sectors. It's hard to get a sense of whether the market is undervalued and going to rise dramatically overall or is overvalued and going to drop significantly. I think different sectors will perform differently, and we're trying to be in the areas that have growth potential and that are insulated from some of the problems out there. That's why we have these different subsectors that I mentioned.

TWST: How have you shifted the emphasis of your portfolios from 12-18 months ago to reflect these top-down views?

Mr. Ullman: The couple of sectors that we're trying to increase would include infrastructure, where we have added a number of stocks, and foreign. We're struggling to find attractive foreign investments because it's more difficult to research them when they're a long distance away. But those two areas are certainly ones that we have wanted to increase.

We're trying to reduce the value-based holdings. Many of them had been consumer-oriented. We never really held any automobile stocks. And there's another whole set of problems with consumer durables — washers, dryers, refrigerator and freezer manufacturers. We've stayed away from those because of the dynamics of the businesses, the problems they're facing from many different sides. Regarding the consumer stocks, I think there's a more than small probability that, given the problem with our budget deficit, given the outsourcing of manufacturing and the risk of interest rates going higher and the devaluation of the dollar over time, we may see a weakening in our standard of living. Now, while that's troubling, it doesn't necessarily need to become a disaster. Still, there are certain things that would be more vulnerable. People might keep cars a little bit longer, for example, or they might downsize, partly for energy efficiencies, to cars that are lower in cost to maintain as well as to purchase, so we are increasingly avoiding firms that are into those cyclical areas — even though we've never had a large position in them.

In the healthcare area, we have switched some of the pharmaceutical companies, given some of the pending issues out there — Celebrex and Vioxx, etc. — and made some changes. We've increased over the last 18 months our biotech positions reasonably significantly, and they're of some consequence now.

So to summarize, we're increasing in the sectors of infrastructure and foreign, the latter being more challenging for us to do, while reducing value-based and also reducing utility stocks — even though they're in mostly our conservative, fixed-income category, which is income-oriented and related to the bond portfolio. Meanwhile, in both technology and health care, we've been doing some changes in subsectors. For most of our portfolios, though, the equity portion, excluding utilities, technology and health care (in that order), would normally represent at least half of the equities. So we are quite concentrated in certain sectors and we've avoided others.

TWST: Would you tell us about some of the stocks in your portfolios that you have held over the last year?

Mr. Ullman: Things change all the time, but we have some companies that might go in the category of core holdings, which, unless something were to dramatically change or valuations got extremely out of line, we would tend to always have in a portfolio. But, like an accordion, we increase or decrease the levels we hold. A few of the companies in that group would be (alphabetically): **Applied Materials (AMAT)**, **Amgen (AMGN)**, **Coca-Cola (KO)**, **Emerson Electric (EMR)**, **Corning Incorporated (GLW)**, **Intel (INTC)**, **Johnson & Johnson (JNJ)**, **3M (MMM)**, **Pall Corporation (PLL)**, **Procter & Gamble (PG)** and **Texas Instruments (TXN)**.

I'll mention a few stocks in technology that wouldn't fall into the core holding group: **Audible (ADBL)**; **Brooks Automation (BRKS)**; **Cisco (CSCO)**; **Hewlett-Packard (HPQ)**; **Honeywell**

(HON); **IBM (IBM)**; **LeapFrog (LF)**; and **Motorola (MOT)**. As an aside, **Hewlett-Packard** had been in our core holding group a long time back. After they acquired Compaq and became more of a commodity business, we thought the stock had a good chance of appreciating because the Board was focused on the value of the stock much more clearly than before. But since it was no longer in that core group, at certain price points we already started selling some of the stock because we were pleased with its recent performance. We're not wedded to that particular security. We're much more open to changes.

In the healthcare field, **Chiron (CHIR)** is one we're starting to sell with the **Novartis (NVS)** deal looking like it's going to go through. **Cooper (COO)**, **Genentech (DNA)**, **Eli Lilly (LLY)**, **Medtronic (MDT)**, **Myriad Genetics (MYGN)**, **Novartis, Regeneron (REGN)**, **St. Jude Medical (STJ)** and **STERIS (STE)** would fall in that category.

Going on to the infrastructure category, we have: **A.O. Smith (AOS)**; a company that went public recently, **Dresser-Rand (DRC)**; **ElkCorp (ELK)**, which is in shingles for houses; **Granite Construction (GVA)**; **Halliburton (HAL)**; **Hardinge (HDNG)** in machine tools; **Ingersoll-Rand (IR)**; **ITT (ITT)**, which we haven't purchased recently, even though they bought out a company some years ago that we had a big position in; **Lindsay Manufacturing (LNN)**; **Quixote (QUIX)** and **Schlumberger (SLB)**. Those would all fall in the group.

Here are just a few examples of value-based names. **DuPont (DD)** is recent. **Hain Celestial Group (HAIN)** is another. **ML Macadamia Orchards (NUT)**, a master limited partnership on the New York Stock Exchange, is a company we've had for quite a few years — it's not a huge holding, but our clients are the largest institutional holders of it. **ML** has a little over 4,000 acres and produces macadamia nuts. It's an agricultural business in which something happens every year — it can be good or there can be a drought or a fungus — and all they do is produce macadamia nuts. It's been interesting over a long period of time. We've recently added back **Tyco (TYC)**. **Union Pacific (UNP)** and **United Parcel Service (UPS)** are also in that category.

As for some of the closed-end funds that we have, there's an index fund in Japan which we're now selling because we had a price target which was reached. Others are: **Aberdeen Australia Equity Fund (IAF)**; **The Mexico Fund (MXF)**, one of our largest in that grouping; **Scudder New Asia (SAF)** and **Templeton China World (TACWX)**. And we've done some things like **China Life Insurance (LFC)** in Beijing. Again, we want to add to that group, and we are looking at that today.

TWST: How do you control investment risk?

Mr. Ullman: We've developed our own models, and we're extremely disciplined. We have a targeted minimum segmentation, meaning a percentage of assets that are in our conservative, out-of-the-general-stock-market category, which would include investment-grade bonds, closed-end bond funds, cash and equivalents, and

certain utility stocks. And if, in any account, whether because of any purchases made or because somebody withdrew funds for some purpose or because the stock appreciated, we end up having below our targeted number, we have alerts to ourselves. And with market movements, I mean, day to day, we could be in and out because once we get more than a slight difference, we act on it. We also keep very close tabs on industry allocations.

Again, the portfolios are individually managed. We also do reviews to look at sizes of holdings as percentages. When things get to be above certain sizes, we'll normally take them down a notch. For core holdings, we'd be more willing to have a larger position than we would for something that's more aggressive, that's noncore.

And the process itself is run by, I think, a very talented bunch of MBAs with a lot of experience who have done a very fine job of following this process.

So there are frequent reviews, there are block trades at price points, and we're able to combine the ability to do larger-volume trades and do allocations through our modeling with the individualized account-by-account approach to look at gains and losses and at the concentrations by industry, etc., that go beyond the normal alerts that we would typically get as we review the portfolios. We've been

ages out — though not equally from every account because of relative size and exposure differences.

Another reason could be news. We eliminated most of our **Merck** (MRK) stock. We don't know how that's going to play out, but we've tried to get in situations where there's limited litigation known, and there's a big question mark about that company, which caused a very sudden change. **Merck** would have been a core holding prior to the news in 2004. We made a very rapid change in that situation. There also could be good news, but there's a combination of price and valuation and news that would change the positioning of a company in terms of our own models.

Earlier, you asked about our sell process. If we were selling a particular security in part — say, we were going to sell 25% of a company — the trading department would be looking at a lot of things. One would be the relative size of the holdings as a percentage of each account; another would be the size of that particular security in its allocated sector; and a third would be the overall portfolio risk segmentation. So if someone held slightly under or a minimum conservative position and we had a stock that we were selling a part of, it would be a high priority to get it sold so that we would end up getting the portfolio back into the normal range.

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improving the technology over time, but the process has been very effective for us. It really is quite disciplined.

TWST: What is the turnover generally in your portfolios? And would you describe the sell process?

Mr. Ullman: In terms of turnover, this is not a targeted number. Average turnover in a client account is dependent on the current bond strategy, since about 65% of the assets are in bonds, and lately all bonds have a short maturity. There is no trading commission when a bond matures and trading costs for equities are at historic lows; so, while total turnover in dollar terms might be 25%-62%, average trading costs might be 10-15 basis points annually. Annual trading costs are low due to recent minimum commission reductions.

TWST: What triggers an exit from your portfolio?

Mr. Ullman: It can be for a number of reasons. One could be a price point. In cases like that, we often hedge and take percent-

TWST: What differentiates your investment approach at Ullman from that of other firms? What are you bringing to the table that others might not be?

Mr. Ullman: I'm not sure what everybody else is doing. What we're trying to do is combine the objectives of the client, their preferences — they may have certain types of industries and companies that they would like to have or that they do not want to have in their portfolios — and then we'll customize the portfolios under a strategy that is developed by a highly experienced account executive who is going through detailed financial planning.

So it's all put together and integrated. It's not just, "Here's some money, please manage it and do a great job for me." We're into all of their expenditures and tax planning and we're willing to undertake things that are basic but that many people don't take advantage of. Folks who give substantially to charity, for example, often

have a major advantage in that they can use appreciated stock to make a contribution. We know our clients very well, and when people are making their charitable gifts, if we have a large appreciation — which we'd be thrilled about long term! — we'd be calling that client and saying, "We're looking at selling this. If you're going to make a charitable gift of this size, why don't we donate this security or perhaps part of your position?" So there are little things that we are able to do.

So we customize as well as take a very specific investment approach. It's sector-related. It's specific. It's not meant to be an index fund in any way, shape, or form. And that clients have a say in terms of the overall strategy is something that's agreed to by all of us.

TWST: How often do you review the portfolios for rebalancing?

Mr. Ullman: That comes from many different angles. The trading department and the research group are doing block trades, essentially, every day, and they're using our models to find the accounts that would be most appropriate to handle those buys and sells based on all of these models. So that's a continuous process.

Then separately, we review all accounts at least four times a year where each account — and portfolio within an account — is looked at individually to make adjustments on a one-on-one basis. So if we find that we have a little too much of a particular stock for various reasons or that we have an industry imbalance that gets out of the normal ranges, those adjustments are made. Or if there are special tax considerations that come into play to realize gains or losses, even during the year, those are done at least four times a year. That's on top of the daily, more modeled kinds of approaches. Then when situations evolve that may require more frequent reviews, the account executives can trigger that. So if funds are deposited, or if there's a need to take funds out or some other factor, we'll add individual reviews to that list. Then the account executives (our financial planners) themselves — though they're not typically the ones making the decisions on the investments — review the accounts regularly and give feedback if they see any kind of need. We also get reports with cash balances because of redemptions and things of that sort that are very helpful.

Thus, it comes from a lot of different angles: there's a continuous review process for portfolio management, individual processes at least four times a year by the investment people with account executive input, plus a review of gains and losses at special times. So there are a lot of different ways that the accounts get looked at.

TWST: What would you say to an investor who wants to invest in the market? What advice would you give him and why is it important to get a balanced portfolio rather than an all-equity or all fixed-income portfolio?

Mr. Ullman: The decision on mix is up to each person's risk tolerance. We've elected from the very beginning and every day since, because of our commitment to ethics and values, to work only

with portfolios that are balanced, where the risk levels are within certain ranges. We don't handle any margin accounts or any kind of leveraged transactions. That's not to suggest that's an inappropriate vehicle for some people, but we've set a range within which we want to work and then if clients, for whatever reason, are not compatible with that, which doesn't make anyone right or wrong, we elect not to take on that account.

But if somebody comes in, the advice in our area of experience is that one needs to understand their own risk tolerances. I'll ask questions along the lines of, "If your portfolio went up 50% in a short time frame, what would that do for your lifestyle? How would that change things?" The other question is, "If your portfolio went down 50% in a short time frame, what would it do to your lifestyle, your attitude and choices?" If it turns out that the hurt for that individual family from a bad outcome was clearly more significant than the benefit of having a positive result, we would very strongly encourage those people not to take high risks.

We try to find a balance where people can find the right thing for them, not for somebody else, and one that takes into account their financial situation, their family circumstances, their longer-term plans, their cash flow needs, and their tolerance for risk. When markets are very strong, we get pushed to get more aggressive and we always resist beyond the point that we've agreed to with a minimum level. When the markets are weaker, people get a little more gun shy.

Our usual experience is that being within a reasonably appropriate range for a client is the best way to go. We will have an accordion-like strategy, where we may have a change in market strategies, but it's always at least a certain percentage conservative for that client. We can always be more conservative, but not materially more aggressive. I think that for people who have worked hard to achieve their asset base, the investments and the assets deserve a lot of respect.

Just as an observation, we find at times that the complicated areas of medical treatments and diagnoses and managing financial areas are two of the most important in people's lives, but because they're complicated and confusing, many folks will just turn over their trust easily to other people who don't provide the appropriate level of respect for those important areas. Some people will do more research on buying a car than they will on their investments or their health situations. It's only because of the complexity; it's not because they don't care.

We believe that when people have worked hard to accumulate what they have, those resources should have a high degree of respect paid to them, and they shouldn't be taken too casually. There are a lot of securities that we will not invest in, period. They're just too aggressive overall.

From a style standpoint, as an aside, we try very substantially to invest in companies where we feel we can be supportive of management. That's a cultural thing. It's part of our ethics and val-

ues. We don't go into a company very often, if ever, where we'd say, "Break the thing up and let's hope that it splits into a million pieces. The sum of the parts is worth more than the whole." We want to be supportive of management and not buy something in the hope that something happens that will shake things up in a negative way.

That's kind of our approach overall as well. We want to have a positive, responsible outlook. Again, that's not for everybody, but the bottom line for us is that we have an extraordinarily high client retention rate; people who think alike are more likely to be happy working together.

TWST: Thank you.

Note: Opinions and recommendations are as of 1/9/06.

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