

# THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

## Investing in Small-Cap Value Stocks



JAMES M. SIMMONS, CFA, is Chief Investment Officer, Chief Executive Officer, and Founder of ICM Asset Management, Inc. With over three decades of experience in financial services, and investment and trust management, he oversees research for all of ICM's portfolios, which are valued in excess of \$2.1 billion. Mr. Simmons earned a Bachelor's degree in Economics from Michigan State University, and is a member of CFA Institute, the Spokane Chapter of the Seattle Society of Financial Analysts, and the Spokane Stock & Bond Club.

### **(ZAG500) TWST: Would you start with an overview of ICM Asset Management and its overall philosophy?**

**Mr. Simmons:** ICM, since very early in its history, has been a firm that has specialized its research and portfolio management in the small and medium-cap value portion of the equity markets. We manage about \$2 billion, three quarters of it focused on that orientation. The reasons we have emphasized small and value are, essentially, because we believe that the combination of these two characteristics enhances our ability to exploit the inefficiencies in what is a fairly efficient market. The smaller the market cap the more inefficient the investment research tends to be and, as a result, the more inefficient the pricing of some of these stocks.

Value investing is also an effort to try to lean into the wind, in spite of market efficiency. A basic investor behavioral dynamic is that when a company has stumbled for some reason such that its stock valuation falls into what most people would generally characterize as value parameters, whether they look at price-to-sales, price-to-book, or other factors, many investors ignore the company's intrinsic value. This tends to create an opportunity to exploit some inefficiencies and potentially capture a bit of incremental return.

**TWST: What is your definition of value investing? Where do you fall within that wide range?**

**Mr. Simmons:** We embrace the idea that for us, value investing involves trying to find companies priced below what their intrinsic or going-concern value would be once they are operating effectively. In essence, what we try to accomplish is finding these companies when, for whatever reason, they are temporarily valued at less than what is justified when they are fully profitable. As a consequence, if one performs thorough due diligence on the companies and the economic sector that they're in (we are also somewhat dependent on making the right sector decisions) then that intrinsic value can and will ultimately be realized by virtue of the market's re-discovery of both the improving fundamental dynamics of the company's sector and its own operating circumstances. We don't buy cheap assets, per se. We are more interested in finding situations where earnings growth will reaccelerate, either as a turnaround or perhaps as an undervalued emerging growth company that still has valuation parameters, which most people would qualify as value.

**TWST: What is the current environment like for your style of value investing?**

**Mr. Simmons:** I think the market right now presents an interesting challenge. If one looks back six or seven years ago as the market accelerated to a peak in the mega-cap tech boom, you had extremely high valuations on the big-cap companies, but at the same

time, interestingly, you had rather extreme undervaluation in small-cap value companies. The grand premise of the market at that time was that big-cap growth was where it was at, and you had to get in front of those money flows. So there evolved a pattern of extreme disparity between small-cap value and big-cap growth.

In the ensuing seven years we've seen two things happen. One, obviously, the mega-cap stocks came down from their excessive valuations to considerably more moderate valuations, which were more reflective of their intrinsic growth. At the same time, value stocks rose in valuation. So we have a tighter valuation band in the market today. When you look at the valuation disparities, or the differences between growth and value and big and small, you find a tighter band than at any time in recent memory — and certainly in my recollection of the past 10 to 15 years. This makes for a rather interesting and challenging environment.

Another thing I want to emphasize is that we operate with the core belief that being in the right sectors, whenever possible, is a critical part of outperforming the market. There are times when a sector is conspicuously out of favor, but where the economics are gradually improving and creating a situation where profitability in that sector or industry will recover, and ultimately, where the profitability for the individual companies will recover, which will be recognized. Those stocks will turn out to be good performers.

*“In a special situation like The Sports Authority, for instance, what we actually look for is a much more definitive change in internal fundamentals. Its current valuation appears to be based on some perceived misstep on the part of the company in the past, but we believe these issues will be rectified by management.”*

In that regard, right now we're looking at a market environment where it's comparatively difficult to characterize any sectors as being particularly cheap or out of favor. The last pronounced sector undervaluation that comes to mind would probably be the tech stocks in the spring of 2003. There was, at that time, a substantial number of tech companies one could identify as good values. In many cases, they had very strong balance sheets. They also had promising prospects for revenue growth, once the technology environment stabilized.

Today, as I mentioned, it is hard to find any sectors that are particularly discounted. Conversely, one sector that we feel is particularly expensive relative to its long-term historical valuation and near-term incremental prospects is the financial sector.

**TWST: Tell us your views on the financial sector and the rising stock environment.**

**Mr. Simmons:** Financial stocks have become fairly expensive from our perspective. Small financial institutions, as a rule, face a

challenging environment when coping with their larger competitors, whether they are banks or insurance companies that have larger IT budgets and economies of scale. Many small operating financials are also highly dependent on favorable yield curve shifts, and a yield curve that is conducive to taking short-term deposits and lending these out longer term at higher rates. The flattening yield curve is counter-productive to this because as short rates rise, the ability to exploit the net interest margin erodes. A very flat curve is starting to develop as the Fed continues to push up the funds rate. And in that environment, it strikes us that with valuations for small banks, small insurance companies, and REITS at the high end of their traditional valuation range, it's very hard to find any incremental positive surprises, which can meaningfully help these stocks. Also, some of the changes in the operating environment are increasing the risk of negative surprises. We consider the financial sector so fully priced that we prefer to avoid it right now.

**TWST: Is top down part of your investment process?**

**Mr. Simmons:** It is, to the extent that we try to evaluate sector priorities and relative valuation. We begin by trying to understand the general backdrop of where the economy is going. Secondly, we want to identify where the investment world has focused its energies and, reciprocally, what areas it has ignored. This gives us a basis for where we would like to devote our research energies.

1-Year Daily Chart of The Sports Authority



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

We have seven full-time analysts and three portfolio managers who also do analysis, so we have 10 people who turn over rocks and evaluate opportunities. Most of our analysts specialize in two or three sectors, but several of us have broad experience. Therefore, we have sufficient knowledge and resources so that when we see a sector that we want to evaluate further, we can direct multiple

either index. This distinction is important because we are an investment team that looks for re-emerging earnings acceleration, and that is not characteristic of all value managers. Today, among those clients who do not favor a custom index, we have some clients who benchmark us versus the value indices and some who compare us to the broader small-cap indices in their investment policy guidelines.

*“Powerwave Technologies manufactures power amplifiers for the cellular phone industry. As you move from one generation of cellular phone technology to the next, it becomes essential to replace your radio amplifiers with next-generation product, and investing in Powerwave is, in essence, an effort to get in front of that reaccelerating capital spending in this area.”*

analysts to that area. This extra manpower allows us to enhance our understanding of the out-of-favor sectors, hopefully optimizing our success in estimating the timing of when it’s likely to recover, and ultimately, which companies we want to own. So there’s definitely an initial top-down part of the process that frames our vision.

**TWST: What is the benchmark by which you compare the performances of your portfolios? In what sectors are you overweight or underweight compared to the benchmark?**

**Mr. Simmons:** That’s a very good question. In the last several years, value investors in small-cap equities have coped with what are likely the final stages of a declining interest rate environment, so financial stocks have done extremely well. They have been helped along by the previously mentioned yield curve changes. In the Russell 2000® or Russell 2500™ Indices, the financial weighting is roughly 22% or 23%, whereas in the Russell 2000® Value or Russell 2500™ Value, the financial weighting is roughly in the 35% range. So to the extent that one looks backward or forward, what index you look at will affect perceptions. After a 20-year bull market in financials during a period when interest rates on the 10-year Treasury dropped from somewhere near 16% in 1982 to 3.1% in June 2003, we don’t expect any additional benefit from a further general decline in interest rates. We are, therefore, significantly underweight in small financials.

As a consequence, where you benchmark a manager is a ticklish question for investors who try to get a clear understanding of how their managers are doing. Because we prefer more flexibility than what is inherently required if you’re going to match up closely with the value indices’ 35% financial sector weightings, which we emphatically do not favor, we generally would suggest that ICM should be benchmarked versus a blend of the core and value indices in some roughly equal-weighted fashion. If a client prefers not to use a custom mix, then either index has merit as long as the client understands the differentiating features of our approach when compared to

1-Year Daily Chart of Powerwave Technologies



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

**TWST: What are the specific characteristics of the companies in your portfolio? What is your decision-making process, and what are you looking for in particular?**

**Mr. Simmons:** That depends on whether we are concentrating research efforts on a particular sector or a special situation. When we can’t find sectors that we feel represent good ideas — where the backdrop for a specific industry or economic sector is compelling and the valuations are cheap — most of the process ends up being individual special situations that may either be turnaround stories or accelerating earnings growth stories, which haven’t yet earned a premium price. The common denominator we look for in all of these investments is companies where valuations exist that don’t ultimately reflect the earning power of each particular company when it’s optimized in a reasonably normal environment. We are not asking for perfection, but we are looking for improved profitability as the driver for investor recognition.

An example of a value-priced, emerging growth story would be a company like Symmetricom (SYMM) that is not really in a turnaround phase, but we think it is not fully appreciated as a quality earnings growth story. It is still modestly enough valued that we feel it fits our value portfolios.

In a special situation — a company like The Sports Authority (TSA) for instance — what we actually look for is a much more definitive change in internal fundamentals. Its current valuation appears to be based on some perceived misstep on the part of the company in the past, but we believe these issues will be rectified by management. In either case, whether we're talking Symmetricom or The Sports Authority, we are not looking for cheap assets; we are looking for earnings recovery and acceleration, and ultimately, a rediscovery by Wall Street that the merit of each company is greater than what they have been willing to believe in the recent past.

nology companies will offer the potential associated with either the next product cycle for their market niche or maybe recovering capital goods demand in a smaller part of the industry. For instance, the big communications carriers, whether we're talking wireless, wireline, or cable, are companies that face the prospect of needing to re-establish their capital spending cycle to remain competitive. There are small companies that will benefit from this even if the broad economy is modestly decelerating.

One example is Powerwave Technologies (PWAV), which manufactures power amplifiers for the cellular phone industry. As you move from one generation of cellular phone technology to the next, it becomes essential to replace your radio amplifiers with next-generation product, and investing in Powerwave is, in essence, an effort to get in front of that reaccelerating capital spending in this area. Symmetricom has some of those same characteristics.

*"A company that we think still has mileage in retailing is Charming Shoppes, led by a talented woman named Dorrit Bern, who was a major factor in the repositioning of Sears' apparel in the late 1980s and early 1990s. We think she is doing an excellent job of repositioning this company around the Lane Bryant brand. The company has substantial cash flow to reinvest."*

**TWST: Do you have some more examples that are representative of your investment strategy? And would you give us the reasons you were attracted to these companies?**

**Mr. Simmons:** The companies I can give you as examples are ones in which we have already established our position. (Obviously, for client-confidentiality reasons, I can't talk about anything we are currently buying.)

If you look at the technology sector, numerous tech companies, as I mentioned, were particularly cheap as we approached the end of 2002 and the early part of 2003. That was a consequence, as many investors know, of the bear market meltdown that began to gain momentum in the latter part of 2000, which ultimately ran for almost three years. We believe that this particular easy money opportunity is definitely behind us. However, we also believe today that when we look at technology we can still find companies that have not been adequately appreciated for their particular niche opportunities.

Let me emphasize one thing we find interesting about technology companies. As a practical matter, small technology companies are, in a sense, always special situations. The macroeconomic trend for large tech companies like Microsoft or Intel, for example, may in a particular time period be lackluster, somewhat positive or somewhat negative, yet at the same point in time, some small tech-

1-Year Daily Chart of Charming Shoppes



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

At the same time, those big carriers are spending money trying to figure out how to optimize the efficiency of their networks, so companies like Micromuse (MUSE), which provide real-time system management software to manage what's going on across entire communication systems, whether they're telecom companies or global corporations, also have potential. All of these are companies

with good balance sheets where we also see the promise of accelerating sales. We are especially attracted to companies like that.

Other companies we look at represent turnaround stories. I mentioned The Sports Authority. That's one that worked well and has considerable additional promise. A more complete turnaround is Men's Wearhouse (MW). They did a number of things that accelerated individual store economics, such as adding formal wear rentals. Another company that we think still has mileage in retailing is Charming Shoppes (CHRS), led by a talented woman named Dorrit Bern, who was a major factor in the repositioning of Sears' apparel from the late 1980s to the mid 1990s. We think she is doing an excellent job of repositioning this company around the Lane Bryant brand. The company has substantial cash flow to reinvest. The Street's perception is that Charming Shoppes' progress to date has been somewhat irregular, but nonetheless, the repositioning of the company is gaining momentum. We think they are poised to take advantage of how they have been positioning the Lane Bryant brand for the next several years. So this is another interesting company in a more traditional turnaround sense.

**Mr. Simmons:** I don't have any one in particular that I feel a need to mention. As a general rule, we don't tout our own favorites, but the ones I have mentioned are good examples of what we think are attractive. I could, however, name one that didn't come up as a previous example. K2 (KTO) is another appealing company in sporting goods. We are seeing consolidation in the sports retailing business, as a result of the merging of companies like The Sports Authority. With the consolidation of these sports retailers, there is a matching trend toward consolidation among their suppliers. K2 is very well positioned to take advantage of this trend.

We also have some investment in natural gas stocks, which came off when oil prices broke below \$50 a month or two ago. Those stocks, unfortunately, have rallied quite a bit in the last several weeks, so at this point, I wouldn't necessarily advocate any particular names. But, we suspect that the natural gas pricing environment will be more durable than most people expect and that some of those companies should deliver decent incremental returns in the next few years.

*“When it comes to individual situations, whether they're undiscovered growth companies or turnaround situations, confidence in management is absolutely essential. Without conviction — and I mean a high degree of conviction — that a management team will execute well, it is probably a bad idea to be in that stock.”*

**TWST:** Would you say that most of your selections are special situations or turnarounds at this point?

**Mr. Simmons:** It varies over time. At this point, almost everything falls into this category. Going back to my comment about the equity markets being relatively efficiently priced now, with growth and value not that extremely different in valuation, and big and small also not that much different, it's more difficult to find anomalies out there. There are many smart people in the investment business, and they have been working since early 2003, picking away at these opportunities, and gradually narrowing the disparities. As a consequence, we just don't see much opportunity at this time to take advantage of anomalies in sector valuation. Those times will come again, subject to events over the next few years, but for the moment, it's not a particularly compelling opportunity. Therefore, we are more special-situation or individual-situation oriented. I draw that distinction because I would call small, emerging growth companies that have modest valuations individual situations as opposed to special situations. That is where we direct most of our energy and it's where most of our recent successes have come from.

**TWST:** Do you have any other companies you want to mention?

**TWST:** Jim, a vital criterion for investment in these small-cap special situations has to be the quality of the management. Do you focus on that? Do you monitor management performance and accountability?

**Mr. Simmons:** That is absolutely essential. I think when one invests in a sector because the sector looks like it has promising turnaround prospects, individual management teams can get an extra boost if we are right about the sector improvement. Energy stocks several years ago, before they became popular, fit this scenario. When choosing a stock within this sector, because the changing sector economics were a lot of what helped drive the companies, individual management skills were somewhat less critical than getting industry trends right. Nonetheless, when you get down to smaller-capitalization companies, there is such a small number of leadership managers that it is essential one do a good job of trying to develop confidence in a company's management team — what their business model is, whether or not you believe they can execute, their leadership qualities, and so on — in order to ultimately get the results you're looking for. So we spend a lot of time on management, even in sector-type investment environments.

When it comes to individual situations, whether they're undiscovered growth companies or turnaround situations, confidence in management is absolutely essential. Without conviction — and I mean a high degree of conviction — that a management team will execute well, it is probably a bad idea to be in that stock.

**TWST: What is the average turnover in your portfolios? And what is the sell discipline? What triggers an exit from your portfolio?**

**Mr. Simmons:** Our turnover is relatively consistent at about two-thirds of a portfolio in a 12-month time period, hence a turnover rate of about 66%. While it bumps up and down a little year to year, it has sustained a remarkably steady long-term average. There's a reason for that.

*“K2 is an interesting company. We are seeing consolidation in the sports retailing business, as a result of the merging of companies like The Sports Authority. With the consolidation of these sports retailers, there is a matching trend toward consolidation among their suppliers. K2 is very well positioned to take advantage of this trend.”*

When we've done the research on a company, by the time we have decided we want to buy it, we will have established several price targets that define our expectations in an objective fashion. We have one that we call our terminal price target. That terminal price target is essentially an effort to try to identify an ultimate price goal for that stock, which reflects, as I mentioned earlier, optimized profitability for that company within its industry and a reasonable valuation on those results. But this is a target that has a somewhat indeterminate time frame because you don't know how long it is going to take to get everything humming and running at an efficiency level that will deliver the type of results we need. So our operative targeting day in and day out is an 18 to 24 month target, which essentially reflects our expectations for each company's progress in that time frame. In other words, we try to get a handle on how the circumstances will improve from today through that 18 to 24 month period. What likelihood is there that the investment community will have begun to recognize the improvement, and what value might they be willing to put on it? This is probably the most critical pricing target we use. It's the one that tends to drive our daily buy/sell decisions. As stocks approach those targets, unless the terminal price target is dramatically higher, we are likely to start trimming because the investment is becoming more fully priced and probably also has a heavier weighting in the portfolio. In sum, the risk/reward is not as good.

We also have, at least for discussion purposes, a six-month price target. This is intended to get us in front of the point in

time, with a reasonable degree of confidence, that the catalysts we think are necessary for a company to start performing will begin to be rediscovered by investors. As you know, there is the classic term, “value trap,” which describes companies that can be bought cheap because their assets are under utilized. But if you look back three or four years later, the same situation still exists. Either management did not have the agenda to fix the problems or the company just didn't have the right catalysts — new product, new market penetration, etc. — to begin stimulating profitability improvement. So our six-month target is an effort to try to get us into a stock when most of the dead money period has passed, yet still give us enough time to accumulate a position before the early-stage rediscovery by other talented value investors.

1-Year Daily Chart of K2



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

**TWST: What about risk in the investment process? How do you attempt to control risk in your portfolios?**

**Mr. Simmons:** We make sure that we have diversification across the various economic sectors so that, to some degree, the risk of a single bad judgment — say, if you're wrong about a particular sector — is mitigated by spreading your decisions over a number of different sectors.

Having said that, I think another important aspect of the question is how one defines risk. The traditional approach in the

vestment business and in the analysis of investment results is to look at variability as a measure of risk or to look at variability of returns relative to a specific benchmark. But as we all know, if we are old enough to have been in this business for any length of time, environments change — sometimes quite substantially — from one three to five year period to the next. Often, as a result, standard adherence to a single benchmark over a period of time is not necessarily appropriate. What worked in one period is not likely to achieve the same degree of success in a subsequent period. So when looking at risk, in addition to wondering about absolute variability or variability around a given index, you also have to look at the risk of inadequate returns. Where does one make the tradeoff, for instance, between the goal of absolute returns and relative returns that otherwise might be consistent with a badly performing index? I think all of these things factor into the issue of how one assesses and manages risk.

*“Small-cap value is a valuable component to most everyone’s overall asset allocation, the one caveat being that small value investors have had several pretty good years in comparison to the general market, so the advantage could be less compelling in the near term. Nonetheless, I think it is a very compelling asset class going forward, and the market always creates new buying opportunities in small-cap value.”*

As value investors, we are interested in getting away from most of the event risk and accompanying price decline that would typically occur when you’re wrong about a company because unloved value stocks are inherently somewhat under priced to begin with. Then you try to position for positive surprises.

From our perspective, the biggest risk in small-cap value investing is the lack of liquidity that comes with the general market when it goes through the occasional sour frame of mind. In this case, thinly traded small-cap stocks — a description that fits a lot of small-cap value companies — tend to sag as a result of the lack of trading liquidity, and the reluctance of people to invest in the small company sectors in an unstable or fearful environment.

**TWST: How many stocks do you generally have in a portfolio?**

**Mr. Simmons:** It varies a bit depending on the market cap range that clients ask us to use. In our portfolios that are dedicated to the smaller end of the small/mid-cap range — companies from \$200 million to \$1.25 to \$1.5 billion — we will typically have 55 to 60 names. That spreads the liquidity issues around better and mitigates the liquidity or event risk in any given company. In the stocks that are still part of the small/mid-cap band we work in, where the range may

be \$500 million to \$5 billion, we are more likely to look at 45 to 50. Because liquidity in these stocks is greater and it’s easier to get in and out, we don’t feel the need to have as many names.

**TWST: Are you always fully invested or do you keep a cash position at times?**

**Mr. Simmons:** We have clients who ask us to approach it both ways. We have a number of clients who prefer to be fully invested because they have a number of different client investment mandates, different manager assignments, and they find not knowing how much cash each manager has is a potentially unwieldy thing in their overall portfolio allocation. On the other hand, we have clients who feel — as we do — that in small-cap value investing, especially at the smaller end of the range, because of the occasional liquidity issues, it is oftentimes beneficial to have some degree of cash in the portfolio. That way you aren’t forced to sell a rather illiquid stock in a hurry just to buy another or vice-versa.

We find, for instance, that an interesting opportunity occurs every year in late summer and early fall to buy companies that are tax-selling candidates for people who are trying to realize losses. Whether it’s a mutual fund trying to make sure it’s done tax selling before the end of October or individuals looking seasonally to beat the year-end rush (although today, we think the rush really comes in September and October), it is helpful to have readily available liquidity. It allows you to buy new opportunities without being forced to sell a stock that has been in the portfolio and is still working. On any given day when you are selling, if you can’t find a buyer for a material number of shares, aggressive selling puts pressure on the stock and excessively depresses the price. So we like to have the option of some working liquidity from time to time. It’s just a question of what level the client is comfortable with.

**TWST: Who are your typical clients? Are they mostly individuals or are they institutional?**

**Mr. Simmons:** It’s both. We have several clients that have accounts in excess of \$100 million; they’re institutional, of course. We also have quite a number of individual clients with accounts that run from \$150,000 to \$200,000 to several million. We work through a number of different relationships with some of the national firms.

**TWST: You have a very distinctive investment approach at ICM. What do you think differentiates it from other companies with a value style?**

**Mr. Simmons:** Two things come to mind. One is a willingness to embrace the core assumption that when you can find sectors that present compelling opportunities, you should take advantage of them. I'm fond of saying and have said for many years, "Economics 101 always wins." We believe that underperforming sectors will ultimately consolidate and returns will improve; over-earning sectors will tend to draw in too many competitors and earnings will deteriorate. As value investors, we are interested in the first pattern rather than the latter. We believe that sector allocation has value, though it needs to be approached in a forward-looking process — something that seems obvious on the surface, but is not as apparent to many people in the investment business as one might expect.

The second thing is our desire to make sure that we truly get our arms around the business model that drives each company and understand what really will make that company a success, rather than just trying to depend on the next quarter's earnings release. We understand that sometimes, especially in value investing, it takes two, three, or on occasion, even more quarters to bring about the change in a company that's necessary to deliver the earnings results we look for. Some of this can be evident if one does a thorough analysis prior to the time the catalyst shows up in the company's earnings power. If you get the company's business model assumptions right, you are ultimately still successful, though perhaps premature. If you don't get the business assumptions right, you almost certainly won't be saved by the quarterly numbers.

What distinguishes us is, first, our willingness to embrace these core assumptions — that having the wind at your back when a sector is improving is something one should always try to do when possible. Second, something we always do, regardless of whether or not the sector opportunities are there, is make sure that we are true to our commitment to understand the operating dynamics of these companies, what drives their fundamental evolution as a company, and ultimately, what drives their earning power on behalf of the shareholder.

**TWST: What advice would you leave with investors entering the market at this time? From what you've told me, stock selectivity must be key. Is it a stock-picker's market now?**

**Mr. Simmons:** Yes. We really think it is. Returns will be nothing like they were in the 1990s. We think people need to invest with more realistic, modest expectations. It is also important for them to understand that when you look at the history of the Russell equity indices over the last 25 years that they have been available, small

value is the best performing of the asset classes over that period. This is based on their separation of the equities in their indices into small value, big value, small growth, big growth, and so on. Small-cap value is a valuable component to most everyone's overall asset allocation, the one caveat being that small value investors have had several pretty good years in comparison to the general market, so the advantage could be less compelling in the near term.

Nonetheless, I think it is a very compelling asset class going forward, and I think the market always creates new buying opportunities in small-cap value. Invariably, some new companies stumble all the time. Some stumble for bad decisions and management gets those fixed. In others cases, it is an inadvertent stumble — not necessarily a bad decision, but one of circumstance. In both cases, these events create new opportunities to invest, so we think you can always find new candidates in small-cap value.

**TWST: Some opportunities lie in mergers and acquisitions. Do you see an increase in that activity among the small-cap companies?**

**Mr. Simmons:** As of today, three of our portfolio companies have been acquired this year, with two in the healthcare space and one in banking. I think it is inevitable in an economic environment where growth will probably slow for many companies that one will see consolidation. Many will be acquisitions where companies are trying to get profitability through increased economies of scale. That will probably be a recurring theme over the next year or two, especially with the low current interest rate environments.

**TWST: Thank you.**

*Note: Opinions and recommendations are as of 6/27/05. Past performance is not a guarantee of future results.*

JAMES M. SIMMONS  
 ICM Asset Management, Inc.  
 601 West Main Avenue  
 Suite 600  
 Spokane, WA 99201  
 (800) 488-4075  
 (509) 455-3588  
[www.icmasset.com](http://www.icmasset.com)