

INVESTMENT PHILOSOPHY

ADAMS FINANCIAL CONCEPTS

Adams Financial Concepts Investment Philosophy

For equities (stocks) A. Michael Adams searches for areas in which he expects to see substantial growth. Once Adams identifies an area of growth, he searches for companies that are undervalued in relationship to their market potential. Adams searches for equities that he believes have twice the upside potential return as they do downside price risk.

Portfolios are concentrated in as few as 10 securities. The time horizon is two to five years to realize the potential, but this is a guideline. Worth in debt instruments (bonds) includes not just the coupon interest, but the capital appreciation/depreciation as well.

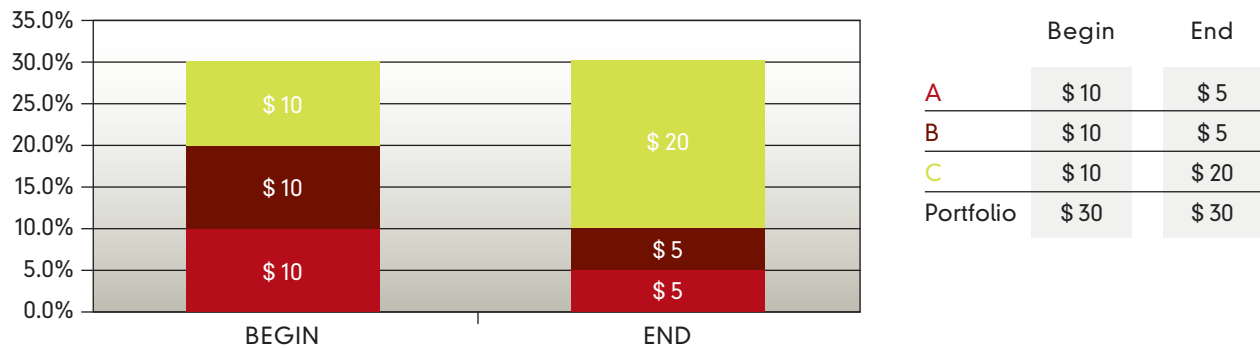
Adams prefers Pacific Northwest securities, but will search in any location, any industry, and any size of company or issuer.

Investment Philosophy Expanded

There is a reason to search for equities that we believe have twice the upside return compared to what we believe to be the downside risk. Here is an example that shows the principle:

Buy three stocks, assuming each has twice the upside potential as downside risk:

If each stock costs \$10 that would mean this: upside to \$20; downside to \$5.



Conventional wisdom on Wall Street says, if you want to make money, you have to be right 66% of the time. This shows if you are right over 33% of the time, you can make some money.

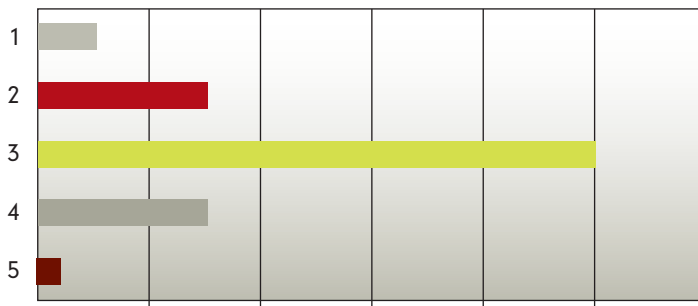
There is no guarantee, of course, that any of the stocks will appreciate. Any and all stocks can potentially go to zero, which would result in a complete loss for the investor.

ADAMS FINANCIAL CONCEPTS

Concentrated Portfolios

The second and third tenets of the investment philosophy concern the number of securities in portfolios. Our approach is to limit the number of securities. From The Warren Buffett Way, "Fisher taught Buffett not to overstress diversification. According to Fisher, investors have been misled, believing that putting their eggs in several baskets reduces risk. The disadvantage of purchasing too many stocks is that it becomes impossible to watch all the eggs in all the different baskets." There is the simple logic that it is easier to watch over and monitor ten companies than it is to monitor 300. Beyond that, it can be shown by mathematical theory that concentrated portfolios, in theory, at least, may outperform highly diverse portfolios.

Imagine a game with five players. Each has a different risk level for his stake. The game has an edge: each time a player wins, he wins \$2. Each time a player loses, he loses \$1. There are 100 plays.



| Player | Bets | Mathematical Return |
|--------|--------------------------|---------------------|
| 1 | \$ 1 each play | \$ 150 |
| 2 | 10% of pot each play | \$ 4,700 |
| 3 | 25% of pot each play | \$ 36,100 |
| 4 | 40% of his pot each play | \$ 4,700 |
| 5 | 51% of his pot each play | \$ 36 |

In this illustration the first player bets one dollar on the first play. If he wins, he wins \$ 2 so his pot is now \$102. On the next play, he again bets \$1, but loses this time. He has a pot of \$101. If this is repeated for 100 plays, the first player will have \$150. The second player bets 10% of his pot. So the player bets \$10 on the first bet. If he wins, he now has \$120. Now, for the second bet, the player bets 10% of the \$120, or \$12 and loses. His pot is now \$108 after two plays. If this strategy is employed under the assumptions above, the ending pot will be \$4,700. The sequence of winning or losing does not matter, according to math because multiplication is "commutative". That is, for example, if the second player lost the first time, his pot would be \$90. Now, betting 10%, \$9, winning the second time, he would win \$18 and his pot would be \$108. That is the same as winning first and then losing.

What this means is this: concentrated portfolios should, in theory, do better than highly diversified portfolios. This conclusion is based on mathematical game theory. To maximize gain, the optimum number of securities, assuming a 2 to 1 reward- risk ratio and a 50-50 chance of winning and losing, is four securities. However, this is only one factor in determining the number of securities in a portfolio. Formula is as follows:

$$E = \{ P (1 + b - 2b^2) \}^{n/2}$$

| | |
|---|-----------------------|
| E | expected value |
| P | beginning principal |
| b | percent bet each time |
| n | number of plays |

ADAMS FINANCIAL CONCEPTS

The Case For Concentrated Portfolios

First Union Securities in September 2000, in their Mutual Fund Focus Report stated:

"Financial Research Corporation conducted a study of concentrated funds with 50 or fewer holdings and found the following (results are as of 2/00):

Over the past 3, 5, and 10-year periods, the average concentrated fund outperformed its category average in all instances.

Over the past 3, 5, and 10-year periods, the average concentrated fund ranked in the top one-third of funds in its respective Morningstar category.

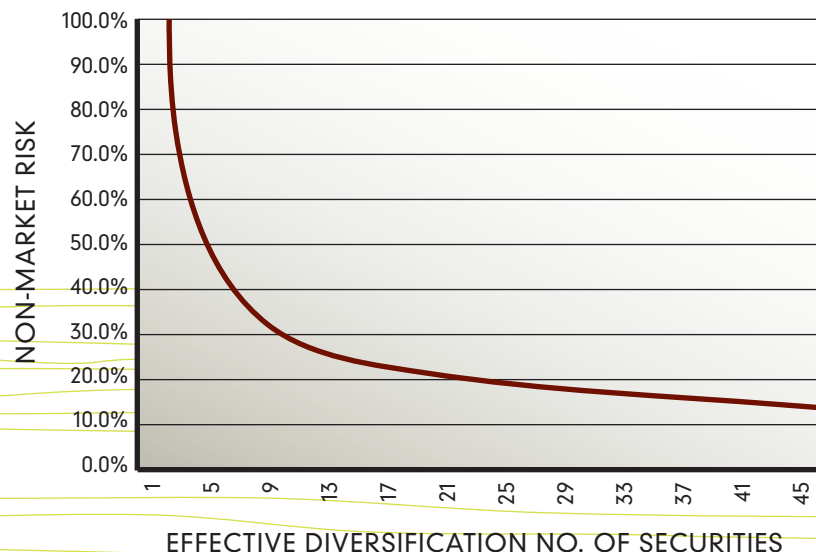
This study found that concentrated funds' higher historical performance came with higher risk as well."

While performance may be better with concentrated portfolios, the volatility increases significantly. What that means is this: there is a relationship between reward and volatility risk. The higher the expected return expected, the higher the volatility risk may be experienced. In fact, studies show that the volatility risk will be approximately twice the experienced return.

Diversification

In 1972, Nobel Prize winner William F. Sharpe published his article "Risk, Market Sensitivity and Diversification," in Financial Analysts Journal showing there was no statistical difference in risk between holding 8-9 stocks and 300 stocks.

EFFECTIVE DIVERSIFICATION VS. NON-MARKET RISK

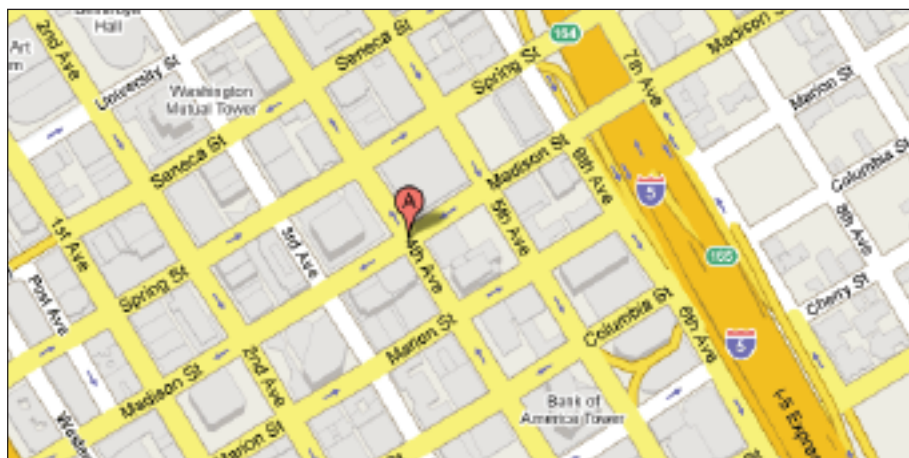


Client portfolios are designed with a minimum of 10 securities and seldom more than 15.

ADAMS FINANCIAL CONCEPTS

Contact Us

Adams Financial Concepts
1001 Fourth Avenue, Suite 2330
Seattle, WA 98154
206.903.1019 (phone)
877.903.1019 (toll free)
206.903-1021 (fax)



Securities offered through Mid Atlantic Capital Corporation (MACC), a Registered Broker/Dealer, member FINRA/SIPC. Investment advice offered through Adams Financial Concepts(AFC), a Registered Investment Adviser. AFC is not a subsidiary or control affiliate of MACC.