Investment
Policy
Statement
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Our mission is to produce above-average, risk-adjusted returns over the long term through a comprehensive proprietary bottom-up research process that allows us to identify inefficiencies in the equity and fixed income markets.

The Berwyn Funds' Five Key Tenets

Value: First, we are value investors. We attempt to exploit the emotions of the marketplace to buy publicly traded securities at discounted prices. Our goal is to purchase assets at prices lower than would be agreed upon in a less emotional private transaction.

Contrarian: Our investment process often leads us to companies that are out-of-favor, or misunderstood by Wall Street's sell side analysts and general public sentiment. We are made up of independent thinkers, so the portfolio's sector weightings and individual holdings may differ from the consensus view. We are not index sensitive.

Bottom-up: The portfolio is built with a "bottom-up" company-by-company screening process that uses certain financial parameters. Although we are keenly aware that broad economic and financial trends affect the value of securities and their underlying business models, we do not attempt to construct the portfolio through macroeconomic factors, such as predictions for Gross Domestic Product growth or the direction of interest rates. Our top down view, if we develop one, is a by-product of our bottom up research.

Independent Research: All of our investment research is performed internally through an exhaustive process which includes the following: a thorough review of the company's financial statements and other publicly-released documents, analysis of the company's competitive position, evaluation of the management team, insider trading activity and other technical factors.

Long Term Point of View: We believe that many security analysts and individual investors form their opinions from a short term perspective, often resulting in impulsive and incorrect decision making. In contrast, once we have made a commitment to accumulate a position in a security, even though its price is under pressure, we remain confident in doing so, unless future developments prove our longer-term assessment to be in error. Frequently, a company's stock, or fixed income instrument, is held for three, or more, years.

Attention to Risk and Reward

We consider ourselves discerning investors. We are willing to be patient in the face of rising asset prices. Our research focuses on the risk and reward of an investment over multiple market cycles. Whether we are evaluating a candidate investment, or reviewing an existing portfolio holding, we are constantly mindful of risk and reward. Most investment ideas faced with this level of scrutiny are rejected. If we determine the risk-to-reward ratio is favorable, then we act. If the risk assessment of an existing portfolio holding becomes negative, it is sold.

Here is the rationale behind this approach. For years, Ibbotson Associates produced their Efficient Frontier Graph. This graph plots two distinct measures – Expected Return and Standard Deviation. For the most part, the relationship shows that as standard deviation (risk) increases, an investor should expect a higher return as compensation. While this is correct in theory, we believe that in practice a manager that consistently takes excessive risk will at some point generate above average losses. More importantly, most investors fail to understand the actual risk they are assuming with each investment. Over any short time frame it is possible to produce a strong return from higher risk investments. However, these returns are generally not sustainable. Inevitably, the higher risk assumed can lead to realized losses.

For most investors, return (reward) is usually the only metric that is tracked. Cocktail-party bragging rarely includes "my portfolio manager's standard deviation is significantly less than the category average" or "my fund's Sharpe ratio is well over 1.00." People are more interested in how much money their investment manager earned, not how they may have avoided losses. We believe that a good investment manager should be able to generate an attractive long-term return without taking excessive risk.

Over any short period, our investment process can be frustrating. Value investing in the face of rising asset prices takes a strong mind and determination. It is analogous to swimming upstream, against the current but in the long term balancing risk and reward provides our investors the potential to earn positive returns without assuming a significant loss of principal. This approach is typically less exciting than investing in risky securities in an effort to achieve short-term gains. However, we contend that our strategy has the potential to be profitable over a sustained period of time. In investing, it is impossible to totally eliminate risk. However, risk can be reduced through a thorough analysis of objective and subjective factors such as financial strength and competitive position. These can potentially limit downside risk by giving a company the ability to survive short-term fluctuations in their business. These attributes can also lead to upside reward and opportunity for long term investors.

Exploiting Inefficient Markets Opportunities

History has shown that financial markets can be driven to irrational extremes by fear and greed. A discerning investor anchored by a strong investment process can act rationally and decisively to take advantage of inefficient markets. Careful analysis, long-term contrarian thinking and patience are essential to removing emotion from the decision making process. When markets sell off, they are apt to do so indiscriminately. Volatility tends to occur in broad waves of negative sentiment, lowering the prices of both high quality and poor quality companies. Inefficient markets create opportunities for bottom-up investors. By focusing upon the fundamentals of a business from a long-term perspective, we believe that we are able to avoid the speculative and most risky areas of the marketplace during bull markets, yet use bear markets as an opportunity to invest in significantly undervalued securities.

Companies are Dynamic Entities

We know that companies are not static. Businesses evolve over time for internal and external reasons. Change does not always equal improvement. Companies can be mismanaged. Management teams experience turnover leading to alterations in strategic direction. Externally, industry positions shift for many reasons. There may be new entrants or new technologies that disrupt the current market structure. Buyers or suppliers may consolidate and increase their pricing power. Rivals can act irrationally, eschewing profit margins in favor of market share gains. These changes in management teams and competitive positions can be subtle or dramatic. No matter the pace of this change, the impact on a company's return on capital can be meaningful.

The future value of a security can be highly dependent upon the quality of the corporate leaders managing the underlying business. A company's board of directors and management team are critical to the success of the enterprise and can be its most valuable asset. Therefore, in evaluating a company and its prospects, we consider the quality and experience of the board of directors and even more importantly, that of senior management, from the standpoint of their ability to effect and respond to change.

In our opinion, whether a company is in the middle of a shift in strategy, or appears to have an entrenched and defendable business model, change is always required to meet new challenges. Consequently, understanding a company's competitive advantages and the ability and motivation of its leaders is an integral part of our initial analysis and an ongoing assessment of our portfolio companies.

Companies with Strong Competitive Positions

Companies with durable competitive positions generally have strong returns on capital. Competitive advantages result from superior research and development efforts, a highly recognizable brand, from being a low cost producer, to marketing a product differently. These attributes and activities tend to result in solid, sustainable profit margins. The ideal portfolio would be completely full of such companies. Unfortunately, these types of companies generally do not trade at large discounts. But, for a patient, long-term investor, these types of companies can be available during periods of market negativity. As a result, when the broad markets become depressed, the portfolio will tend to have more companies with these characteristics.

Turnaround Situations

When the broad investable market is depressed or undervalued, the quality of company we are able to purchase is generally high. When the investable market becomes overvalued, we tend to invest in companies that are undergoing some type of internal change or "turnaround." These companies generally have lower returns on capital than those with superior competitive positions. However, turnarounds tend to have specific characteristics indicating potential improvement. Some of these changes can include a new management team, a shift in strategy, a new product, an acquisition or a divestiture. Each of these events can spur our interest in a company.

Value Traps

While we are careful, we are not perfect. We can make well-educated but poor judgments. Our most common mistake is investing in what turns out to be a value trap. A value trap is a company whose security trades at a discounted valuation, but the factors leading to this discount may be appropriate or more permanent than initially expected. Some turnarounds do not turn around. The market may be correct in lowering the price of a security below our opinion of fair value. It is incumbent upon us as portfolio managers to act decisively when we recognize our mistake in order to minimize the potential downside risk inherent in these types of investments.

The Equity Research Process

Our comprehensive quantitative and qualitative research process includes an analysis of objective and subjective characteristics. It takes time and discipline. It requires sound, unemotional judgment and patience. When employed correctly, it has produced positive results from a risk-reward perspective.

Equity Investment Universe

Our investable equity universe is All-Cap. Our screens will include any stock with a market capitalization of $125 million or greater. As a result, the portfolio will tend to have a higher percentage of small cap stocks relative to similarly managed portfolios. Equity holdings in our fixed income strategy require a minimum dividend yield of one percent at time of purchase, although we are not required to sell a position if the dividend is eliminated.

Generalists

Each member of our investment team is a generalist and as such, conducts research across a variety of industries. We believe this is important for several reasons. First, it gives our analysts a broad view of what is occurring in many different industries. Second, it prevents an analyst from becoming overly focused on one area and eliminates the perceived requirement to recommend an investment in one particular area of coverage. What appears to be attractive on a relative basis may not be attractive on an absolute basis. We believe that this generalist approach provides a broad perspective of our investable universe. It gives us the ability to identify irrational behavior in the markets. This broad perspective across economic sectors and industries allows for an unbiased view of our investable opportunities. It provides consistency to our goal which is to attempt to outperform through individual security selection.

Quantitative Factors

Our research includes a review of statistical data, including financial statement and financial ratio analysis of the company's historical performance. Wall Street, in our opinion, overemphasizes financial models based upon quarterly results. Analysts tend to get lost in short-term earnings results and lose sight of the long-term drivers of future performance. Our financial ratio analysis includes up to fifteen years of historical data, giving us a solid, long-term perspective that most analysts ignore.

Return on Capital (Return on Assets / Return on Equity): In our opinion, the most important measure of a company's long term success or failure is their return on both equity and assets. We analyze how this data trends over time. We also review the component pieces of the return. These components include – sales growth, profit margins, asset turnover, financial leverage, etc. This analysis provides us with an understanding of the strength of a company's industry position, how well management has performed over time, and what strategies management should be focused on in order to maximize their future returns. A company's return on capital is the ultimate gauge of competitive strength and long-term earnings power and is the basis for which all of our research is directed.

Balance Sheet Strength: In general, we put a high degree of emphasis on a company's financial position. A strong (or improving) balance sheet, meaning little to no debt and a solid cash position, provides flexibility during all market environments and cycles. It can also be a source of competitive strength, allowing a company to continue to execute a long-term plan or pursue opportunistic acquisitions during downturns.

Free Cash Flow Generation: In general, a company whose business is not capital intensive (requires low levels of capital expenditures) is preferable. A company that can generate significant levels of free cash flow has the ability to fund their debt, make acquisitions, pay dividends and repurchase shares without having to rely on the capital markets.

Qualitative factors

Qualitative factors can be much more difficult to evaluate, but they are no less important in developing a full understanding of the risk and potential reward inherent in an investment candidate. Many of the subjective factors that we review will be found in reading company filings (annual and quarterly reports), from listening to conference calls and through speaking with management teams.

Management Team Quality: Is the management team capable of achieving their stated goals based upon their past experience? We will typically want to see some level of managerial success, whether it be in their current positions or with companies they were employed at in the past. What types of managers have they been in the past? What strengths or weaknesses have they shown?

Stated Company Strategy: Do we agree with the stated strategy as laid out by the management of the company? Is management's stated strategy appropriate given their company's financial and competitive positioning? Is the strategy too aggressive or too passive given the current environment?

Management Incentives: Are the management team's interests aligned with shareholders, or are they placing their own interests before those of shareholders? Is management's compensation consistent with achieving their corporate goals? Do the executives and the board have a history of being good stewards of shareholders' money?

Insider Transactions: Are members of the management team buying or selling stock? Do the management team and board of directors hold a significant ownership stake in the company?

The Fixed Income Investment Process

A key differentiator of our fixed income investment process is that we apply our research process in the same manner for equity and fixed income securities.

Fixed Income Investment Universe

Our fixed income investable universe is broad. In the corporate bond market we have the opportunity to invest in both investment grade and high yield-rated securities, convertible bonds and preferred stock. The portfolio can also purchase U.S. Treasury securities, U.S. Agency securities, Mortgage-Backed and Asset-Backed securities.

Comprehensive View of Capital Structure

We view a company across its entire capital structure, which allows us to identify value in a specific issuer's common stock, corporate bonds or preferred securities. This all-inclusive view of a company's publicly traded securities allows for deep knowledge from a research perspective and adds flexibility to our trading. This also provides a view of the capital markets that equity or fixed income specialists seldom see. We can identify changes in equity valuation versus credit spreads. This approach allows us to determine if management's credit-related standards are being met or if their capital raising goals are unrealistic.

Ability and Willingness to Reduce Debt

Our fixed income research attempts to determine two key factors: the ability and the willingness of an issuer to satisfy its debt obligations. The ability to pay down debt is based upon objective statistics and is relatively easy to assess. We review a company's debt load relative to its total assets and cash balances. We analyze interest expense coverage and the long term cash generation ability of the enterprise. A management team's willingness to pay down debt is typically more difficult to ascertain, but is no less critical to selecting an investment candidate. Willingness is judged from qualitative factors, including a review of company's public comments regarding their balance sheet, their past decisions in utilizing debt and their historical results. In many instances we will conduct conference calls with candidate companies, with the assessment of their willingness to pay down debt being one of the primary topics.

Self-Funding Companies

The great majority of our fixed income holdings are issued by companies with strong or stable competitive positions and an ability to generate a significant amount of free cash flow. During downturns, companies that are self-funding (companies that can generate enough free cash to fund operations and outstanding debt) are able to avoid the need to access the capital markets at inopportune times. Companies that are not self-funding are dependent upon the capital markets to fund operations. This capital market dependence can lead to significant risk including restructuring of debt or, in the worst case, ultimate default during periods when credit markets tighten.

Determining Proper Valuation

As value investors, it is impossible to execute an investment process without a firm understanding of security valuation. Our definition of intrinsic value ties the worth of a business to its long-term, sustainable return on capital. Our investments typically fall into one of two categories. First, a company with a history of strong returns on capital, but the market has lowered their valuation due to short-term factors. Second, a company with a weaker historical track record, but is undergoing internal change which we believe can lead to stronger returns on capital in the future. The securities in which we invest, including fixed income securities, are intended to be purchased at a discount to their intrinsic value. For stocks, we generally purchase securities that are trading at a low multiple of what we believe to be their long-term earnings power, which comes from our analysis of their long-term return on capital. With our fixed income investments, we generally seek to purchase bonds and preferred stock that are trading at discounts to par.

Equity Valuation - Low P/E versus Value

Stocks that trade at low price-to-earnings ratios are not always value stocks. This short-term metric can at times be misleading. Valuation metrics such as price-to-earnings (P/E), price-to-book (P/B) and price-to-sales (P/S) are a starting point in our search for undervalued securities. We would argue that these measures need to be placed in their proper context. A low 'P' does not mean much if a company's 'E' is not sustainable. A thorough understanding of the underlying company's business is necessary to identify true value. In many cases a low price-to-earnings ratio may indicate that the company is cyclical and they have reached peak potential earnings. In other cases a low valuation may indicate that the overall business is very competitive and the investment will have a hard time generating a strong return on capital. Our long-term approach to evaluating the potential of an investment takes all these factors into account when reviewing short-term valuation metrics. We are searching for more than just a cheap investment; we are looking for value.

Fixed Income Valuation - Total Return versus Income

Every security in our investable universe pays some level of income. For stocks, the minimum dividend yield is one percent. For fixed income, the yield level has frequently been higher than the bond or preferred stock's coupon rate, with most of our purchases being done at a discount to par value. Since we attempt to buy bonds at a discount, we believe this provides our investors with increased potential for capital appreciation and total returns in excess of the yield for each security.

Fixed income investing would be easy if it was as simple as selecting the highest yielding securities. It is not that easy. Typically fixed income securities with higher yields are attached to securities that have higher risk. We believe that the most important factor for a fixed income investor to focus on is the potential total return for the investment over time. The potential total return for an individual bond includes both the yield and potential capital appreciation. We attempt to find bonds whose prices may appreciate over time due to positive credit factors. We call these factors – positive operating momentum. Positive operating momentum exposes itself clearly in a company's financial results. They are shown through some combination of improvement in the following metrics – sales growth, operating income growth, interest expense declines, free cash flow stability or growth. These factors are heavily influenced by a management team's willingness to reduce debt and maintain a strong financial profile. Our credit analysis includes the analysis of subjective factors which could lead to credit improvement.

Purchasing bonds that are trading at discounts would seem to be a minor distinction in our fixed income investment process, but we believe it is a particularly important factor. It aids in reducing the price risk associated with higher priced bonds, and helps us avoid overheated fixed income markets. It also allows us to take advantage of undervalued fixed income markets.

This way of thinking about the fixed income markets also allows us to see through the "relative yield" strategy that many other bond managers employ. We believe that a strategy focused strictly on relative yield removes the focus from where it should be, which is the combination of absolute yield and price risk. If absolute yields are abnormally low, the value in credit spread measures can be weakened. In our portfolio, the absolute yield and potential total return must be sufficient enough to offset the potential risk assumed in each specific security.

Asset Allocation

The Berwyn Income Fund will have one major allocation constraint – a 30 percent maximum stock allocation at time of purchase. Equities can become greater than 30 percent of the total portfolio only through appreciation.

Amongst the broad allocation categories – stocks, bonds and cash – the portfolio's allocation will be determined by where the portfolio manager sees value. Over the long term, the fund has averaged approximately 25 percent in stocks, 65 percent in bonds and 10 percent in cash. These allocations, however, fluctuated quite a bit in the past 10 years. If equities present good value, the portfolio will typically have more than 25 percent in stocks. When we view fixed income to present good value, the portfolio would have more than 65 percent in bonds and preferred stock. The size of the portfolio's cash and cash equivalents are typically a result of the value we find in both equities and fixed income. When we view both stocks and bonds as being overvalued or presenting a poor ratio of risk and reward, the portfolio will have elevated levels of cash. In recent years, the portfolio's cash balances have fluctuated between 0 percent and 30 percent.

Portfolio Composition/Constraints

The portfolio has typically held between sixty to eighty individual companies/issuers. The portfolio can hold multiple securities of any particular issuer. The great majority of these issuers will be U.S. based companies trading in U.S. markets. In the past, the portfolio has also purchased American Depository Receipts (ADR's), which are non-US equities whose stock also trades on a U.S. exchange and corporate bonds of foreign companies denominated in U.S. dollars.

Our focus on credit research has led to a substantial portion of the fixed income portfolio being comprised of corporate bonds. Our strategy's intent is to add value through credit research and not through duration/interest rate positioning. We believe that this approach is more predictable and repeatable, as opposed to attempting to forecast the direction of interest rates.

The fund is typically concentrated in bonds with credit ratings between BBB and B. There have been times in the past when credit spreads were abnormally tight and absolute yields attractive enough to justify purchases of US Treasury and US Agency securities, including mortgage-backed securities (MBS). But in most periods, the fixed income portfolio has primarily consisted of Investment Grade and High Yield Corporate bonds and preferred stock. Convertible corporate bonds have also been an attractive area of investment, and during certain periods have been a substantial portion of the portfolio. The risk-reward balance of convertible securities, especially those purchased during market downturns, can produce favorable risk-adjusted returns.

The primary investment constraint is that the portfolio cannot, at the time of purchase, own more than thirty percent in common stock. As a risk management tool, the portfolio has general position weighting guidelines. A normal position size for a common stock is one to one and a half percent. For a fixed income holding, a normal position size is two to three percent. In the event the portfolio owns both the equity and fixed income securities of one issuer the maximum position size at purchase is three percent. In each of these cases, position sizes can appreciate through these stated limits.

The portfolio has generally not held more than twenty percent in any one economic sector. The portfolio has typically had a modified duration within +1 / -1 year of the Citigroup Broad Investment Grade Index.

Summary

Our investment philosophy is anchored by five key tenets – Value, Contrarian, Bottom-Up, Independent and Long Term. Viewing our investable markets through this lens provides the framework for our decision making process. Every investment decision considers the potential risk and reward inherent in each security. The goal is to opportunistically build a portfolio of income-producing securities of companies that have a strong or improving competitive position and a trustworthy management team. Our research process is bottom-up. Our analysts are generalists and we invest in companies in a multitude of industries. The research process requires a thorough analysis of both quantitative and qualitative factors. This process can lead the portfolio managers to areas of its investable universe that are strongly out of favor. As such, the primary risk to the portfolio tends to be security specific. The portfolio has proven to be flexible in terms of its asset allocation and underlying holdings within its stated constraints and guidelines. The portfolio's cash position is the result of this bottom-up research process. When opportunities are plentiful, the fund tends to have a low cash balance. When there is a dearth of quality investment candidates, the portfolio's cash balance tends to be elevated. In the past, the portfolio has not relied upon sector bets nor has anticipated moves in interest rates. The portfolio is not index sensitive.

Investing in any mutual fund involves risk, including the risk that you may lose all or part of the money you invest. The Berwyn Income Fund invests in both fixed-income and equity securities. The Fund's investments in fixed-income securities are subject to such risks as: interest rate risk; call risk; default risk; high-yield (junk bond) risk; and unrated bond risk. The Fund also invests in equity securities which carry the potential for unpredictable drops in value and periods of lackluster performance. For additional information on these risks and other related risks (non-principal), please review the full prospectus.

An investor should consider the investment objectives, risks, and charges and expenses of the Fund carefully before investing. The Fund's prospectus contains this and other information about the Fund and should be read before investing. The Fund's prospectus may be obtained by downloading it from the Fund's web site (www.chartwellip.com) or by calling 1-888-995-5505.

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