



	Average Annual Total Returns Through 12/31/08					
	One Year	Three Years	Five Years	Ten Years	Since Inception	Net Expense
<b>FBR Funds - Investor Shares</b>						
<b>FBR Pegasus Fund<sup>TM 1</sup></b>	-31.86%	-3.74	n/a	n/a	-2.94%	1.25%
<b>FBR Pegasus Mid Cap Fund<sup>TM 1,4</sup></b>	-18.91%	n/a	n/a	n/a	-11.36%	1.35%
<b>FBR Pegasus Small Cap Fund<sup>TM 1,4</sup></b>	-27.29%	n/a	n/a	n/a	-10.64%	1.45%
<b>FBR Pegasus Small Cap Growth Fund<sup>1,4</sup></b>	-37.08%	-5.64%	n/a	n/a	-3.21%	1.45%
<b>FBR Focus Fund<sup>1,4</sup></b>	-33.85%	-4.56%	3.06%	9.67%	11.02%	1.42%
<b>FBR Small Cap Financial Fund<sup>1,2,4</sup></b>	-8.73%	-7.40%	-1.93%	8.95%	10.24%	1.49%
<b>FBR Large Cap Financial Fund<sup>2</sup></b>	-29.11%	-10.68%	-4.54%	1.98%	5.32%	1.88%
<b>FBR Technology Fund<sup>1,3</sup></b>	-42.89%	-11.97%	-4.03%	n/a	-0.95%	1.84%
<b>FBR Gas Utility Index Fund<sup>5</sup></b>	-28.30%	-0.29%	6.73%	5.22%	8.11%	0.70%

Effective May 30, 2008, FBR Fund Advisers, Inc. (the "Adviser") has agreed in writing to waive a portion of its investment advisory fees and assume certain expenses of each Fund to the extent annual fund operating expenses exceed 1.25%, 1.35%, 1.45% and 1.45% of the FBR Pegasus Fund<sup>TM</sup>, FBR Pegasus Mid Cap Fund<sup>TM</sup>, FBR Pegasus Small Cap Fund<sup>TM</sup> and FBR Pegasus Small Cap Growth Fund<sup>TM</sup>, respectively and 1.95% of the Focus Fund, Large Cap Financial Fund, Small Cap Financial Fund and Technology Fund's average daily net assets (excluding interest, taxes, brokerage commissions, acquired fund fees and expenses, extraordinary legal expenses, or any other extraordinary expenses),

except for the Gas Utility Index Fund. With respect to the Gas Utility Index Fund, the Adviser has agreed in writing to waive a portion of its advisory fees and assume certain expenses of the Fund to the extent annual fund operating expenses exceed 0.85% of the Fund's average daily net assets (excluding interest, taxes, brokerage commissions, acquired fund fees and expenses, extraordinary legal expenses, or any other extraordinary expenses). The Adviser has agreed to maintain these expense limitations with regard to each Fund through October 31, 2011.

**PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.** Current performance may be lower or higher than performance data quoted. To obtain performance data current to the most recent month-end, please call 888.200.4710 or visit [fbrfunds.com](http://fbrfunds.com). Investment return and principal will fluctuate so that investors' shares, when redeemed, may be worth more or less than their original cost. The performance data does not reflect the deduction of redemption fees and if reflected, the redemption fee would reduce the performance quoted.

- 1 - The non-diversified nature of the Fund may subject investors to greater volatility than other diversified funds.
- 2 - Fund investments are focused in the financial services industry, which may be adversely affected by regulatory or other market conditions, such as rising interest rates.
- 3 - Fund investments are focused in the technology sector, which may be affected by developments in the technology industry and its related businesses.
- 4 - Investing in mid- and small-cap companies can involve risks such as less publicly available information, higher volatility, and less liquidity than in the case of larger companies.
- 5 - The Fund is subject to risks associated with the natural gas industry which is sensitive to interest rates, weather and competition risks.

As of 12/31/2008, Wal-Mart Stores, Inc. represented 1.59% and 1.35% of the Pegasus and Technology Fund's assets respectively; Intel Corp. represented 3.33% of the Technology Fund's assets

**Investors should consider the investment objectives, risks, charges and expenses carefully before investing. This and other important information can be found in each fund's prospectus. To obtain a free prospectus, please call 888.888.0025 or visit [fbrfunds.com](http://fbrfunds.com). Please read the prospectus carefully before investing.**

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# Forbes

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MUTUAL FUND SURVEY

## Good Things, Small Packages

Low-cost index funds should get the bulk of your savings. With the risk portion, aim for a market-beating result by getting a small fund from a top-performing family. By James M. Clash and Zack O'Malley Greenburg

**W**HAT'S THE BEST PLACE TO PUT YOUR RETIREMENT savings? If you want to put it all in one fund (not usually a good idea), and if you think that past performance is the best measure of how good a fund is (we don't), your answer can be easily found. Just go to a fund data source and screen for long-term results. Hottest fund over the past 20 years: Vanguard Health Care Fund, up 15.8% annually. Alas, that performance is not much of a guarantee that this fund will be the hottest—or even above average—in the next 20 years.

Here's a different way to approach the problem. What's the best fund family to do business with? We went about answering this question three ways. We measured fund families by composite stock market performance (on U.S. portfolios), by costs and by service. This broader analysis assumes that you are making judgments about a long-term relationship with a fund group and expecting to invest in more than one portfolio. It does not hinge on the illusory notion that a single outlying performance statistic can be replicated.

We divided our universe of 57 fund families into two groups: the giants, with more than \$75 billion in equity funds, and the rest, ranging in size down to Sit Mutual Funds, with \$400 million. The four giant vendors are Vanguard Group, Fidelity Investments, American Funds and T. Rowe Price. They share these features: lots of choices, comparatively low costs and enough funds to make it likely that performance averages will land near the middle of the pack. The last feature is a statistical fact of life, the law of large numbers.

The 53 small fry, not surprisingly, include the performance outliers—both clunkers and stars. These smaller families tend to run up higher costs. We counted as a family any group with at least three U.S. equity funds holding a minimum of \$25 million in assets in each fund.

Among the largest, American takes the ribbon for equity performance, with a compound annual return over the past 20 years of 9%. That compares with 8.4% for the S&P 500 index. Vanguard gets the honors for low costs, with an overhead and management fee (a weighted average for all funds and all 20 years) of 0.37% of assets annually. Among the big four, Vanguard is also our favorite for service.

# MUTUAL FUND SURVEY

The performance champ among smaller families is Heartland, with a composite return since 1988 of 11.3% annually. That number largely reflects the stellar results of one outstanding portfolio: the Heartland Value Fund, run since 1984 by William Nasgovitz, who focuses on micro-caps. Other families with strong performance were FBR Funds, Brandywine, Weitz, FPA and Baron.

The most economical of the small-family winners is FPA, with a composite 20-year expense ratio of 0.98% on funds buying U.S. stocks.

Measuring the performance of a group of funds is a tricky business. Numbers you see are often contaminated by misweighting and/or survivorship bias.

Suppose Family X has two funds, with \$2 billion and \$1 billion of assets today and results over the past 12 months, respectively, of 100% and 0%. What's the weighted average performance number? The naive answer, using today's assets as weights, is 67%. We do the numbers a different way, using midyear figures. By that measure, 59% is the correct answer, not 67%.

In real life the distortion you get from end-of-period weights is worse than shown in our hypothetical. That's because hot funds attract new customers while weak funds lose customers. The ending asset figure greatly overstates the base on which the excellent results were earned.

To get our family performance stats we take a weighted average result for each of 20 one-year periods, using all of a family's funds in operation for that year, then concatenate the 20 averages to get a long-term result.

Next problem: survivorship. Star funds survive, and their results find their way into advertisements. Stinker funds have a way of being discontinued and then vanishing down the memory hole. But they don't vanish from our memory.

Our database goes back to 1976 and includes month-to-month performances on 3,244 U.S. equity funds that have existed since then. Most of the raw data comes from Lipper, a subsidiary of Thomson Reuters. When a fund is liquidated or merged out of existence, we keep the old

## Family Affairs

Bigger isn't always better. Of the ten top-performing fund families over the past 20 years, Janus and Davis are the only ones with more than \$10 billion in assets today.

FUND FAMILY	20-YEAR ANNUALIZED TOTAL RETURN <sup>1</sup>	ASSETS 11/30/08 (\$BIL)	20-YEAR AVERAGE EXPENSES PER \$100 <sup>1</sup>	CURRENT EXPENSES PER \$100 <sup>1</sup>
<b>TOP 10</b>				
<b>HEARTLAND</b>	11.3%	\$1.8	\$1.42	\$1.17
<b>FBR FUNDS</b>	10.4	1.0	1.13	1.27
<b>BRANDYWINE</b>	10.2	5.4	1.14	1.10
<b>THIRD AVENUE</b>	10.2	6.9	1.26	1.08
<b>DAVIS</b>	10.1	29.7	1.02	0.86
<b>WEITZ</b>	9.5	1.5	1.32	1.16
<b>JANUS</b>	9.5	39.6	0.98	0.90
<b>FPA</b>	9.3	1.3	0.98	0.89
<b>GABELLI</b>	9.3	5.2	1.46	1.38
<b>BARON</b>	9.3	9.9	1.54	1.41
<b>BOTTOM 5</b>				
<b>ING</b>	5.7	2.4	1.46	1.14
<b>VIRTUS<sup>2</sup></b>	5.7	2.3	1.30	1.36
<b>CALVERT</b>	4.3	1.9	1.51	1.27
<b>FIRST INVESTORS</b>	3.7	1.8	1.43	1.38
<b>COLUMBIA</b>	3.3	50.4	1.32	1.06

Performance through Dec. 31, 2008. <sup>1</sup>Asset-weighted. <sup>2</sup>Formerly Phoenix Funds. Sources: *Forbes*; *Lipper*.

data. Unpleasant outcomes do not get swept under rugs.

The market crash of 2008 is a reminder that you should evaluate funds separately in bull and bear markets. People who used raw five- or ten-year past performance to pick a fund a year ago were unprepared for the ensuing crash. In our rankings of 899 U.S. equity funds we award separate grades for up- and down-market performance. A full listing of funds and their grades can be found at [forbes.com/fundsurvey/](http://forbes.com/fundsurvey/).

During the past three downturns the S&P 500 has given up one-third of its value on average. It's these times when the best flagship funds have proved their mettle. In the tech bust that ran for 30 months through September 2002, when the S&P 500 lost 44%, Neuberger Berman Genesis was up 26.2%; Heartland Value, 10.9%; and FPA Capital, 9.4%.

So, where do you put your retirement money? Our advice is to put at least half

of your equity money in broad index funds tracking U.S. and foreign indexes. (We didn't evaluate foreign index funds in this exercise, but the fund vendors that offer the most economical U.S. index funds tend to have good buys in foreign index funds, too.) Select these core funds for low cost and quality of service. Plan on leaving this money untouched for 20 years.

With the balance of your equity allocation you can be more adventurous. If you want a good chance at beating the market with your risk capital, you should probably be in a small fund, one with less than \$1 billion in assets. Giant funds have a hard time racing ahead of the pack. The table at the top of the page shows that eight of the ten best-performing fund families are small. Three of them—Heartland, FPA and Weitz—have nimble flagship funds with less than \$1 billion in assets that have beaten the S&P on average

across the three bear markets over the past two decades.

Understand, though, that while a small fund has a better shot at an unusually good result, it also has a higher chance of delivering a terrible result. We found no evidence that small funds outperform large ones as a group, at least when the effect of survivorship bias is carefully excluded.

So, aim for a home run, but do it with your risk capital. If you are a conservative type, perhaps only 10% of your stock market money goes into one or more actively managed small funds, with stodgy index funds getting a 90% share.

What do the gunslingers look for in a stock? David Ellison, chief investment officer at FBR Funds (number two on our list of outperforming small families), prefers companies whose tangible book value has been growing. Among Ellison's favorites: Wal-Mart and Intel.

"If you make \$2 a share and pay a \$1 dividend, but book value is growing less than a dollar, where's that [other] money going?" he asks. "I want companies ... that don't lose in translation through dilutive share offerings, expensive buybacks, stock options and bad investments."

Wallace Weitz, founder of Weitz Funds, says he likes companies whose market value seems to be well below what they would be worth to an acquirer. "While the business value of a company may not change from quarter to quarter, the share price can because of human nature," Weitz says. Companies he says are bear market bargains: Berkshire Hathaway, Microsoft and WellPoint.

Ronald Baron, founder of Baron Funds, says his secret sauce is hanging on to winners. He holds on to stocks for an

average of five years, versus a one-year fund industry average. His biggest winners show twentyfold and better gains over very long holding periods. The list includes Charles Schwab (since 1992), Robert Half International (since 1991) and DeVry (since 1990).

"If you go to the trouble of finding a great company, what good is it to sell after a 50% or 100% gain?" Baron asks. "You just have to find a replacement."

Steven Romick, a partner at First Pacific Advisors, says he avoids fads. "Success is not just what you own," he says. "It's what you don't own." Romick's shunning of tech in 1999 helped FPA Crescent post a 44.7% gain in the two and a half years through September 2002, even as the S&P 500 fell 44%.

Performance and cost are easy to handicap; numbers don't lie. Our third category, service, is a bit fuzzier. To rank it, FORBES called the toll-free numbers of 29 fund firms five times each in December between the peak hours of 3 p.m. and 5 p.m. We timed how long it took from the first ring to get through to a real person and then how long it took to find the answers to two basic questions: What is your largest domestic stock fund, and what is its annual portfolio turnover? The latter question is key to gauging whether a fund is a long-term investor or a stock flipper that is likely to leave investors with fat bills for short-term capital gains and trading commissions.

Some fund families justify higher expenses by touting prompt, competent service. Hours spent on hold listening to Kenny G yielded the conclusion that most offer neither. Of the 21 fund families that outperformed the S&P 500 the past 20 years, only Weitz, Baron and Davis could

answer our questions consistently in less than three minutes. The majority took much longer or were unable to answer them at all.

Vanguard was among the best, averaging a respectable 3 minutes, 37 seconds. But in one case a phone rep who correctly identified the family's largest domestic stock fund (the S&P 500 index) insisted its turnover ratio was proprietary. It's actually available in the fund's prospectus and on Morningstar.com.

Some large families, like Janus and T. Rowe Price, provided consistently mediocre service, taking five minutes on average to come up with answers.

Others were utterly clueless. Third Avenue Funds managed to best the S&P 500 by 1.8 percentage points annually over the past two decades, but it doesn't seem to employ a phone rep who can even define a turnover ratio.

"Everybody who is familiar with that is in a meeting," sniffed a voice after seven minutes and five transfers. After six minutes on the line with American Century, an employee managed to name the family's biggest fund but then mounted an inquisition about our second question. "Why do you want to know what the turnover rate is?"

At least he tried. After five attempts Sentinel's switchboards never even yielded a human being.

The saddest performance of all? Alger Funds. Its 1.87% expense ratio over the past 20 years is the highest average of any family, yet its reps were able to answer both our questions only once. **F**

*Additional reporting by Keren Blankfeld Schultz and Claire Obusan.*



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