Quality Growth Investing
A Series of Reports From Jensen Investment Management

Patience is Still a Virtue

The Merits of Quality Growth Investing

The underpinning of Jensen Investment Management's investment foundation is our conviction that true investing involves making a commitment to share in the long-term success of a business. That philosophy is in direct contrast to others' approaches of betting on the short-term movement of a company's stock price.

However, we acknowledge that the markets are driven by alternating bouts of fear and greed:

- Rising stock prices breed optimism; buyers are lured to pay increasingly higher prices for the promise of earnings to come.
- Falling stock prices bring a compounding sense of pessimism that causes sellers to flee, even as the reduced share prices may then represent better long-term values.

We use the words "buyers" and "sellers," rather than "investors" or "owners," as it is our hope that those with an ownership mentality could set aside the emotions that cause overreactions in buying and selling. But human emotion may be the most difficult factor to remove from the investment equation.

This challenge, in our view, is precisely why a focus on business fundamentals is absolutely critical and why quality growth companies should be a long-term foundation of investors' portfolios.

What Do We Mean By "Quality"?

Defining "quality" can lead to differing opinions. Without listing all possible definitions, we believe that most students of business performance will agree that certain vital elements must be recognized in assessing the quality of a company.

These include:

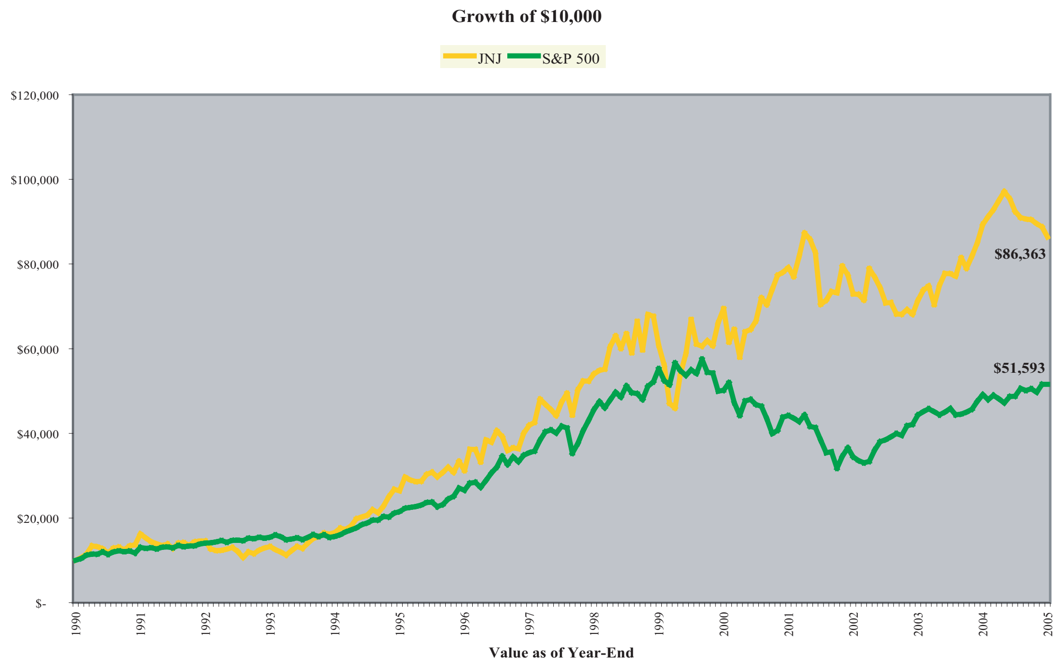
- Consistent returns above a firm's capital costs;
- Earnings purity and growth in earnings;
- Free cash flow;
- Dividends, long overlooked but lately very much back in favor, must be factored into the evaluation when considering their importance within the context of historical total returns;
- Balance sheet strength of a business can help distinguish between higher and lower quality firms;
- Qualitative issues, such as assessing the strength of management teams, the power of brands, patents, distribution systems, installed bases of clients and so on, must also be critiqued.

What Quality Means for Investors

- **We believe that quality growth companies can provide investors with a high degree of predictability when focusing on business performance.** In our opinion, businesses that have demonstrated an ability to grow free cash flows and earnings over an extended period of time, by definition, should be more predictable in their future performance.

Predicting the next Google is a difficult task. Seeking out a quality growth company with ten or twenty years (or more) of persistently high business performance is less Herculean.

A worthwhile example is that committing to an investment of $10,000 in Johnson & Johnson in 1990 (certainly not "sexy" at the dawn of the Internet age, but sporting a fifteen year history of solid rewards to shareholders) would have led to an account balance today of nearly $90,000, or a total return of more than 800%.



This represents the growth in a $10,000 investment in Johnson & Johnson (with dividends reinvested) during the 15-year period ended December 31, 2005 versus a growth in the same amount invested in the S&P 500 Index (with dividends reinvested) during the same 15-year period. Past performance does not guarantee future results. You cannot invest in an index. **The Jensen Portfolio initiated its position in this company in May 2002 and therefore has not held Johnson & Johnson during the entire period covered by this chart.**

• **Persistency is a trait of quality growth companies that should be reassuring to long-term investors.** Jensen Investment Management invests solely in businesses that have produced a return on shareholder equity of 15% or greater in each of the past ten consecutive years.

We believe that a business that is strong enough to exceed this hurdle for a sustained period is much more likely to continue operating at a high level. While this may seem to be a severe requirement, over time, the staying power of these businesses has often supported our belief.

Businesses such as Pepsi and Emerson Electric have not only produced ten consecutive years of such performance, but more than thirty consecutive years at these high levels. Historically, the market, however fickle in the short-term, historically has rewarded this outstanding business performance by way of an enhanced stock price.

• We believe that businesses with slower but steady growth can produce better returns for shareholders over time. Conversely, rapidly growing companies -- while catching the attention of opportunistic growth investors -- may not be able to sustain their high rates of growth. These types of "one-hit wonders" often destroy shareholder value over time.

While these firms may experience rapid bursts of growth over short periods, they often do not generate the strong and growing free cash flows required to fund their incremental growth.

This has been supported by research done by California Polytechnic State University finance professor Cyrus Ramezani. Companies were studied for the eleven year period from 1990-2000. Four groups were established according to sales and earnings growth, with those in the first quartile exhibiting the slowest growth. Each group was then measured for alpha creation over the period to determine whether shareholders were, in fact, compensated for their risk-adjusted opportunity cost of capital.

Reviewing the study, Forbes writer Daniel Fisher noted that "companies consistently in the third quartile of growth - stalwarts like Wal-Mart, AutoZone and Intel - had stocks that far outperformed their faster-growing cohorts in the fourth quartile, such as Merisel, Limited and Toys "R" Us. The difference in risk-adjusted returns averaged 7.5% a year, based on a subgroup of 2,300 firms that reported sales and earnings growth sufficient to put them in one of the two quartiles for at least three years in a row."

Ramezani and his colleagues concluded that "maximizing growth does not maximize corporate profitability or shareholder value. On the contrary, companies with moderate growth in sales or earnings show the highest rates of return and value creation for their owners."

• Behind every quality company is a keen management team that understands the importance of returning excess cash to its rightful owners, the shareholders.

Within these firms, growth is an outcome of a sound corporate strategy, not the goal itself. Management teams, however small or large the organization, are always a focal point in determining quality companies. A management team that understands its role as stewards of the shareholders' dollars, the clients' needs and the well-being of employees is likely to pilot a business that can excel through even difficult times and prosper long-term.

As recently as the latter part of the 1990s, a management team that consistently paid an increasing level of dividends to shareholders was derided as being short of ideas for fueling future growth. Quality growth businesses may well have higher priority uses for redundant cash, such as reinvesting in the business, paying down debt, or making strategic acquisitions.

Within quality growth businesses, paying dividends versus using free cash flows for other purposes is not an either/or proposition; the payment of an increasing stream of dividends is a consequence of the strength of the business itself. The role of these dividends is readily seen in total returns to equity investors over the long-term. Fully 41% of total equity returns came from dividends during the period from 1926 through 2004, boosting returns from 6.1% to 10.5% annually. The 2003 dividend tax cut which reduced Federal taxes on dividends to 15% is an additional plus for taxable investors and has put the spotlight on dividends.

The Importance of Patience When Investing in Quality Companies

Owning a portfolio of quality growth companies does not automatically mean that the market will reflect each business' value being created each quarter or even every year. There are periods, sometimes extended, when the market more greatly rewards the share prices of lower quality businesses.

Research has been done on this topic by Brandywine Asset Management using the quality ratings assigned to stocks by Standard & Poor's. From September 2002 through the end of 2003, companies S&P rated lowest, with ratings of C and D, returned 85% while those with a higher ranking of B-minus to B-plus returned 35%, and those companies ranked A-minus to A-plus returned a more paltry 24%. This "flight from quality" rally following a bear market is typical, Brandywine notes, and occurred in both the periods of 1974-1975 and 1982-1983. "As the economy improves, the lowest-quality names get an early big bang" Brandywine explains.

The Jensen Approach to Quality Growth Investing

Jensen Investment Management's sole focus is on the management of a quality growth equity portfolio. We derive this portfolio from a select universe of companies that have produced a long-term record of persistently high returns on shareholder equity. Jensen believes that the long-term returns generated by the stock and dividends of a quality business reflect its long-term growth in earnings and free cash flow. We firmly believe that sustainable competitive advantages and persistent, strong business performance yield long-term growth and capital appreciation, while minimizing investment risk.

Based upon our experience and academic research, quality growth companies can maintain high return-on-equity and use growing free cash flow to invest in the companies competitive advantages and deliver shareholder value.

Professional investors often raise questions about our approach to risk control. In our view, risk control comes from addressing business risk. In current day terms, that means not waking up to an Enron in the portfolio. We feel risk control also emanates from addressing pricing risk through the buying of high quality businesses at a discount to our estimate of their intrinsic value, and selling when prices exceed intrinsic value and provide the potential for attractive returns. We believe this form of risk control can enable investors to participate in market gains while potentially providing some downside protection.

About Jensen Investment Management

Jensen is the investment adviser to The Jensen Portfolio, an equity mutual fund, and to separate accounts for our private wealth clients and institutional clients. The firm's investment team manages investments for its clients using a singular approach that has been applied consistently over time. As experienced, mature investment advisers, the team strongly believes that enduring wealth comes from owning great companies for a long time.

The Jensen Investment Discipline

The Jensen investment team believes that true investing entails participating in the long term success of a business instead of speculating on short term movements in its stock price. From an investment universe of companies recording a minimum 15% return on equity for each of the last 10 years, we seek 25 high quality growth businesses representing our best ideas for inclusion in client portfolios. These companies possess several common characteristics including: what we believe are sustainable competitive advantages, business returns in excess of capital costs, shareholder friendly management and growing free cash flow that is available to reinvest in the business, for making strategic acquisitions, to repurchase shares and pay increasing dividends -- ways that deliver current shareholder value or increase the value of the business over time.

Investments are made when shares can be purchased for a significant discount to Jensen's estimate of a business' intrinsic value in an attempt to create a portfolio with less risk than the overall securities markets. We will remain invested in a business unless it fails to meet our minimum business standard of a 15% return on equity (indicating a loss of competitive advantage), becomes overpriced in the market, or is replaced by a better idea.

As of September 30, 2006, the Average Annual Total Returns for The Jensen Portfolio - J Shares were 8.75%, 7.53%, 5.66% and 9.47% for the 1-, 3-, 5-, 10-year periods, respectively. As of September 30, 2006, the S&P 500 Index's Average Annual Total Returns were 10.79%, 12.29%, 6.98%, and 8.62% for the 1-, 3-, 5-, and 10-year periods, respectively.

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. To obtain updated performance information that is current as of the most recent month end, please call 1-800-992-4144 or visit www.jenseninvestment.com. All returns include the reinvestment of dividends and capital gains. Performance shown is for the Class J Shares; performance for other Fund shares classes will differ.

This material must be preceded or accompanied by a prospectus for The Jensen Portfolio that contains information about the Fund's investment objective, risks, charges and expenses. Please read it carefully before you invest.

As of September 30, 2006, the Fund held the following positions (as a percentage of net assets) in the companies mentioned: Emerson Electric 5.03%; Pepsi 4.07%; and Johnson & Johnson 4.53%. Fund holdings and sector weightings are subject to change and are not recommendations to buy or sell any security.

The Fund is non-diversified, meaning that it may concentrate its assets in fewer individual holdings than a diversified fund, and is therefore more exposed to individual stock volatility than a diversified fund.

Mutual fund investing involves risk; principal loss is possible. The information provided herein represents the opinions of Jensen Investment Management, and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice. Fund holdings and sector weightings are subject to change at any time and are not recommendations to buy or sell any security.
Quasar Distributors, LLC – Distributor (10/06)

ALPHA: The alpha of a mutual fund describes the difference between a fund's actual return over a period of time and its expected return, given the fund's level of risk. In this case, the risk profile of the Fund is measured by the Fund's beta.

ROE: The average annual earnings from total operations divided by common stockholders equity. Return on Equity (ROE) measures the return on each dollar invested by the common stockholders in a company.

EPS: The portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability.

S&P 500 Index: An index of the share prices of 500 US companies reflecting the general trend of the US stock market. The index covers the shares of industrial, transport, utilities and financial corporations. The index is unmanaged and you cannot invest directly in an index.

Jensen Investment Management®

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