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Third quarter 2007

IDEAS AND INFORMATION FROM THE TURNER FUNDS

Growth mantra

What office-copier companies were to the 1960s and Internet-network companies were to the 1990s, Internet-search companies are to this decade: the premier growth companies of their time. Few, if any, people are more familiar with the Internet-search companies' extraordinary success than Jason Schrotberger (right), security analyst/portfolio manager. He was one of the first analysts to sense the Internet-search companies' business potential, and his perceptions on how the companies have realized that potential have been quoted by the news media regularly.

Some reporters who have called Jason lately have characterized the sharp rise in Internet-search stock prices this year as a symbol of the current resurgence in the growth-investing style. "They ask about the risks in Internet-search stocks' rich price/earnings ratios," he says. "My mantra is that, yes, based on *trailing* 12-month earnings, Internet-search shares look expensive. But if you take into account *forward* earnings projections, if you think Internet-search companies' earnings could grow 15% or more annually over the next three years—as we do—the stocks aren't nearly as expensive. We would rather own a fast-growing Internet-search company that's selling at a high multiple than a much cheaper company whose earnings are growing just 5% per year. As long as the Internet-search companies can continue to deliver on earnings, we think they can continue being great growth stocks."

INSIDE

PORTFOLIO MANAGER SPOTLIGHT

Vijay Shankaran: "Drugs and medical devices have inelastic demand; they meet needs that our society will pay for, even when the economy is weakening."

Vijay Shankaran, 34, is a security analyst/portfolio manager on our Growth Equity Investing Team and helps covers the health-care sector for our growth-stock portfolios. He earned a bachelor's degree at Dartmouth College, an MBA degree at the University of Pennsylvania's Wharton School of Business, and doctor of medicine and doctor of philosophy degrees in immunology at Washington University. He joined our firm in 2006, is a principal, and serves as a comanager of the Touchstone Healthcare and Biotechnology Fund.

On health care's recent track record

"The financial press has been quick to point out that the health-care sector—or more specifically, the S&P 500 Health Care Sector Index—has underperformed the stock market over the past three to five years. But we think that's a bit misleading. The S&P 500 Health Care Sector Index has sizable weightings in a few big drug stocks that have skewed its performance for the worse; the large-cap pharma stocks haven't performed especially well in the last few years.

"But other types of health-care stocks, like biotechnology stocks, *have* done well. For instance, the American Stock Exchange Biotech Index is up more than 50% from the second quarter of 2004 to the second quarter of 2007. It's *those* types of companies, in the more dynamic segments of the sector, that we've been focusing on."

On the demand for health care

"To us, one of the investment appeals of the health-care sector is that it has both growth *and* defensive characteristics. Drugs and medical devices have inelastic demand; they meet needs that our society will pay for, even when the economy is weakening. So the earnings of companies that are involved in biotechnology or make medical devices, for instance, tend to be relatively immune from economic downturns. And going forward we think biotechnology and medical-device companies should in fact do well and generate stable, above-average earnings."

On the benefits of pharmacogenomics

"One emerging health-care discipline that we think bears watching is pharmacogenomics; pharmacogenomics basically enables researchers to study how different drugs interact with patients with different genetic makeup, so as to improve drug development. As a result patients can be tested for their sensitivity to certain drugs, and the drugs can be applied to the patients who would benefit most from them. We think pharmacogenomics, among other things, may help drug companies to justify the prices of new, expensive drugs by showing clearly how the drugs assist certain subsets of patients."

On biotechnology companies' promise

"The biotechnology industry continues to pick up momentum. The leading biotechnology companies have consistently beat Wall Street's revenue and earnings estimates, and they are likely to continue doing so, in our view. They have established solid drug franchises to treat problems such as HIV, pulmonary arterial hypertension, and cystic fibrosis. We see growth opportunities for the elite biotechnology companies in Europe and elsewhere overseas.

"To cite one example of an innovative new biotechnology product: a drug has been developed to help patients suffering from a rare, life-threatening blood disorder called PNH—paroxysmal nocturnal hemoglobinuria, which affects as few as 10,000 people worldwide."

On the baby-boomer market

"We think there's some truth to the conventional wisdom that the so-called graying of America will benefit the health-care sector. There are 76 million baby boomers who will inevitably face the chronic diseases of old age—a huge prospective market for the companies that can develop drugs to treat those diseases. Another big market: cosmetics that help boomers deal with the effects of aging on their appearance. For example, in 2005 more than 3 million procedures were performed with Botox to smooth facial frown lines. It's a highly profitable segment of the sector, since the boomers—not the insurers—largely pay for cosmetic treatments out of their own pockets."

On the prospects of universal health care

"I would say that the probability of a universal health-care system being established in the U.S. any time soon is quite low. Americans have made it clear again and again that health care is a priority, so they are willing to pay top dollar for it. We think health-care costs as a percentage of the nation's GDP will continue to increase. That obviously can't go on forever, but the U.S. has shown a high tolerance for the rising costs so far. Everyone talks about reforming the U.S. health-care system, and there's been lots of heat but very little light about how the system should be reformed. Health care has some of the most vocal critics of any industry, and the media seem to have an insatiable demand for sound bites from those critics. Health care is much in the news because it's an industry that affects *everybody*, which is one reason why I think it's an interesting industry to cover; the reality is that everyone has health problems at some point in his or her life."

ASK US

Q: "The stock market seems to be in a fierce tug-of-war between the bulls and the bears lately, which has been reflected in an increase in volatility. The market has turned more risk averse, with investors worrying that new problems related to subprime mortgages may yet surface and, more importantly, that corporate earnings growth has slowed. In the past two quarters, the S&P 500 Index companies have reported earnings gains in the single digits after 20 consecutive quarters of double-digit gains. How is the slowing rate of earnings growth likely to affect the stock market in the near term, in Turner's view?"

John V. Sturiale
Director, Charles Schwab Investment Management
Richfield, Ohio

A: "Earnings and earnings expectations have consistently delivered positive surprises since the bull market began in 2002, and we think they are likely to continue doing so. Second-quarter earnings were 8.1% higher than they were a year earlier. Only a few weeks before, Wall Street analysts were more pessimistic, looking for earnings increases of just 3.3%.

"As for future quarters, earnings are expected to improve. According to the ISI investment-research firm, third-quarter earnings are forecast to be up 6.1%; fourth-quarter earnings, 12.2%. Also, Merrill Lynch's domestic and global profit indicators remain positive, which prompted the firm to characterize the profits outlook as 'healthy,' if something less than robust.

"As always, there are a lot of things that could go wrong to hurt earnings and the market's prospects. Unemployment could pick up. A geopolitical problem could send oil prices and inflation soaring higher. The subprime-mortgage crisis could produce more bad news, a loss of liquidity for corporate debt, and a worldwide credit crunch that chokes the global economic boom. But we think the probabilities are that the global economy should continue to do well and earnings should rise.

"For the year-to-date through August 17, the broad-based Russell 3000 Growth Index is up 4.48%, outperforming its value counterpart by 3.55 percentage points. We think growth, after more than six years of underperformance, has finally returned to favor—aided, somewhat ironically, by the deceleration in earnings growth. In our view, as companies with above-average earnings growth become more scarce, investors are gravitating to bona fide growth stocks. We believe the shift to growth investing is only in its early stages.

"Our research has shown that during periods of rising volatility, investment strategies geared to earnings tend to do best. Volatility often reflects heightened risk aversion. And risk-averse investors in turn tend to become less concerned about stock valuations and pay up for reliable earnings growth. We think that's in fact happening now and the fundamental underpinnings of the bull market, such as an expanding economy, earnings growth, strong corporate cash flow, and favorable earnings yields on stocks, remain in place."

Bob Turner
Chairman and chief investment officer

INVESTMENT BRIEFS

Kiplinger's lauds Midcap Growth Fund


Chris McHugh

The Turner Midcap Growth Fund offers an effective means of investing in mid-cap companies that can grow faster than their giant counterparts, said *Kiplinger's Personal Finance* magazine in its July issue.

The Midcap Growth Fund, led by Chris McHugh, senior portfolio manager/security analyst, "looks for companies with accelerating earnings and positive share-price trends," Kiplinger's observed. The result: a fund "filled with supercharged stocks that sell at lofty P/Es," the publication noted, citing our preference for buying richly valued stocks with superior earnings growth, rather than stocks with lesser valuations and growth rates. The fund can provide "a good balance" for investors' value holdings, but "invest only if you have a strong stomach," in light of its wide swings in performance historically, the magazine noted.


Frank Sustersic

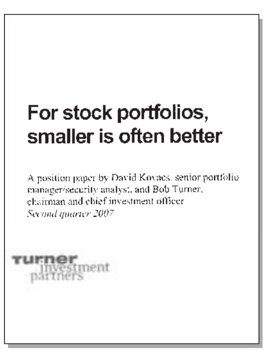
Morningstar profiles Emerging Growth Fund

Strong stock-picking sets the Turner Emerging Growth Fund apart from its peers, according to Michael Breen, Morningstar senior fund analyst, in a commentary in June. "Lead manager Frank Sustersic's strategy is similar to many growth managers'; he just executes better," Mr. Breen observed. "Sustersic has consistently hit the mark using quantitative and bottom-up analysis to identify small firms with surging earnings."

Like all growth funds specializing in small-cap stocks, the fund will have its "volatile patches," Mr. Breen noted. "But we're confident that management's skills will continue to pay off over the long term." The fund is closed to new investors.

New paper: the merits of asset limits

When it comes to a portfolio's assets, less can be more, according to our latest position paper, *For stock portfolios, smaller is often better.* Numerous investment studies have documented the phenomenon known as the size effect–the inverse relationship between the size of assets under management and the ability to outperform. Once assets reach a certain mass, investment performance of a portfolio tends to worsen.


For stock portfolios, smaller is often better

A position paper by David Kovacs, senior portfolio manager/security analyst, and Bob Turner, chairman and chief investment officer
Second quarter 2007

turner investment partners

In the paper, by David Kovacs, senior portfolio manager/security analyst, and Bob Turner, chairman and chief investment officer, it's noted that to improve our own chances of delivering superior investment performance, we early on established asset limits for our portfolios. Detailed are our current asset limits, which were updated in July. To receive a free copy of the paper, call us at 484.329.2329.

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1. The Turner Funds are distributed by SEI Investment Distribution Co., Oaks, Pennsylvania 19456. The investor should consider the investment objectives, risks, charges, and expenses carefully before investing. This and other information can be found in the prospectus. A free prospectus, which contains detailed information, including fees and expenses, and the risks associated with investing in the funds, can be obtained by calling 1.800.224.6312. Read the prospectus carefully before investing. Mutual-fund investing involves risk, even the potential loss of principal.

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4. The indexes mentioned are unmanaged statistical composites of stock-market performance. Investing in an index is not possible.

5. There is no guarantee that any fund will own stocks that increase in price even when the general market indexes are rising, have risen, or will rise in the future. Holdings are subject to change.

6. Funds that invest in small and/or mid-size company stocks and narrowly focused investments typically involve greater risk, particularly in the short term, than those investing in larger, more established companies.

7. This newsletter was published on September 5, 2007, and has an expiration date of October 31, 2007.

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THIRD QUARTER 2007

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