QUALITY GROWTH INVESTING

A Series of Reports From Jensen Investment Management

The Power of Fundamentals

July 2009

The Efficient Market Theory

The efficient market hypothesis, later known as the efficient market theory (EMT), was first expressed by Louis Bachelier, a French mathematician, in his 1900 dissertation, "The Theory of Speculation". EMT emerged as a prominent theory in the mid-1960s when economist Paul Samuelson began to circulate Bachelier's work among his peers. In 1970, famed economist and author Eugene Fama published a review of both the theory and the evidence for the hypothesis. The paper extended and refined the theory and included the definitions for three forms of financial market efficiency: weak, semi-strong and strong.

Proponents of EMT believe perfect information exists in the stock market. In other words, whatever information is available about a stock to one investor is available to all investors (except, of course, insider information that is illegal). Therefore, the price of a stock should, they reason, reflect the total knowledge and expectations of all investors.

This theory further suggests that investors should not be able to "beat the market" since it would seem improbable to know something about a stock that is not already known to all and reflected in the stock's price. Proponents of this theory do not try to pick stocks that are going to be winners; instead, they simply try to match the market's performance.

Contesting EMT

Since the 1970s, much has been written about the accuracy and use of EMT. Evidence suggests that it may not always work as theorized.

For example, from March 24, 2000 to March 29, 2001, the NASDAQ stock index declined from 4,963 to 1,821 – a 63% drop. According to EMT, on each of those days the price of each of the stocks in the NASDAQ should have reflected all of the knowledge and expectations of all investors. In other words, the market should have been perfectly priced.

It is difficult to believe that the market was perfect on both days. Surely, on at least one occasion, the market was wrong or such a dramatic reduction in the value of these securities (reflecting the value of the underlying businesses) would not have happened over such a short period.

A more recent example was the nearly 57% decline that occurred from the previous S&P 500 Index peak of 1,565 on October 9, 2007 to its most recent low of 677 on March 9, 2009. Investors should wonder — on which one of these days was the market perfectly priced?

Fundamentals Drive Stock Prices Over the Long Term

While EMT might explain how stocks move on a minute-to-minute or day-to-day basis, we believe that the underlying fundamentals of each business will drive investor returns over longer periods. More specifically, assuming price to earnings (P/E) ratios remain unchanged, a company's total stock return (TSR) should equal the earnings per share (EPS) growth rate plus the dividend yield. The following analysis illustrates this relationship.

Total Stock Return*

Period	0	1
P/E ratio	12	12
Stock price	$60.00	$66.00
EPS	$5.00	$5.50
Dividends/share		$1.50
Dividend Yield		2.5%
EPS growth rate		10.0%

TSR = EPS growth rate + dividend yield
TSR = 10% + 2.5% = 12.5% OR
TSR = (stock price change + dividend) / stock purchase price
TSR = ($6 + $1.50) / $60 = 12.5%

** This is a hypothetical example for illustration purposes only and is not indicative of the actual return likely to be achieved by an investor.*

So, what is an investor to do -- believe in the efficient market theory and buy investments that track to stock indices or search for the stocks of high quality, growth companies with consistently strong fundamentals?

We believe the latter approach should yield favorable results when compared with the appropriate index.

Growing Revenues, Profit Margins and Earnings

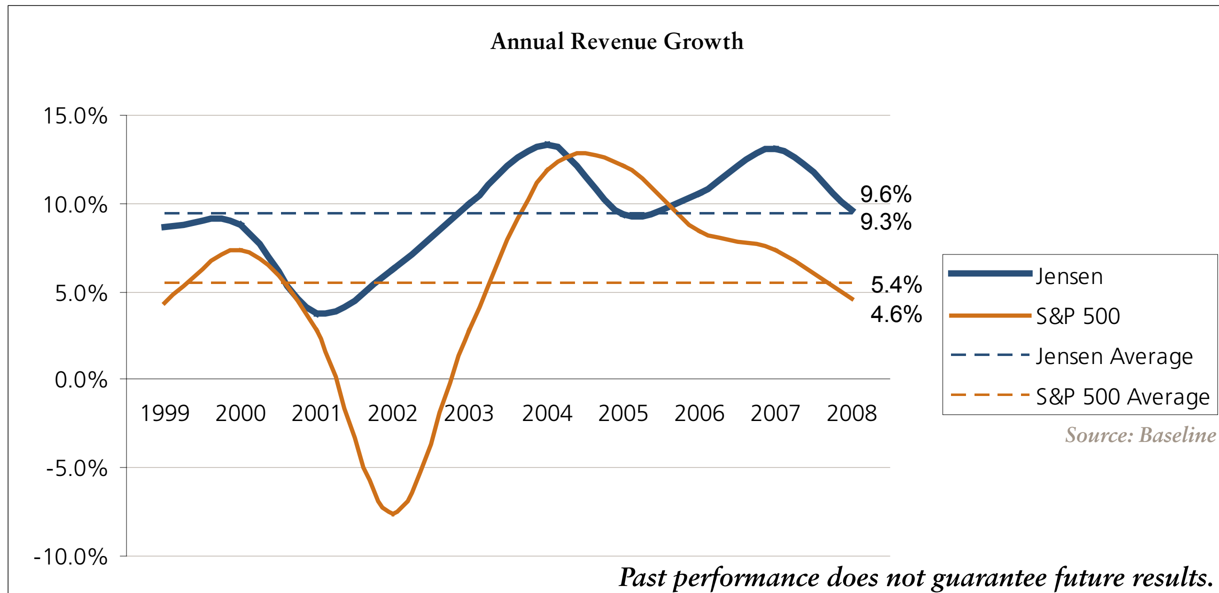
To explain our long-held belief, we thought it would be worthwhile to review historical fundamental criteria for the 28 companies currently owned by The Jensen Portfolio and compare these data to the companies in the S&P 500 Index. We chose these 28 companies, using their weightings in the Fund as of June 30, 2009, and a 10-year time frame because data points were readily available. However, please note that this historical analysis of the Fund's current holdings does not imply that an investor experienced these results by owning The Jensen Portfolio, as actual holdings and portfolio weightings during the last 10 years were dissimilar to those of the current portfolio. In addition, please see the disclosures at the end of this paper for the Fund's historical performance information as of the most recent calendar quarter end.

Every company in the current Jensen Portfolio has recorded at least a 15% return on equity for each of the last 10 years. We believe that they possess sustainable competitive advantages and are run by shareholder-friendly managers. Generating surplus cash that is used to reinvest in the business, make acquisitions, repurchase shares or pay dividends is a hallmark of these companies.

Nothing happens in a company until a sale occurs. Therefore, it would seem appropriate to start

with revenue growth. High quality, growth companies typically achieve strong revenue increases because their products and services are perceived as superior to their competition, their markets have attractive growth characteristics and their management teams are experienced in navigating changing business, economic and interest rate environments.

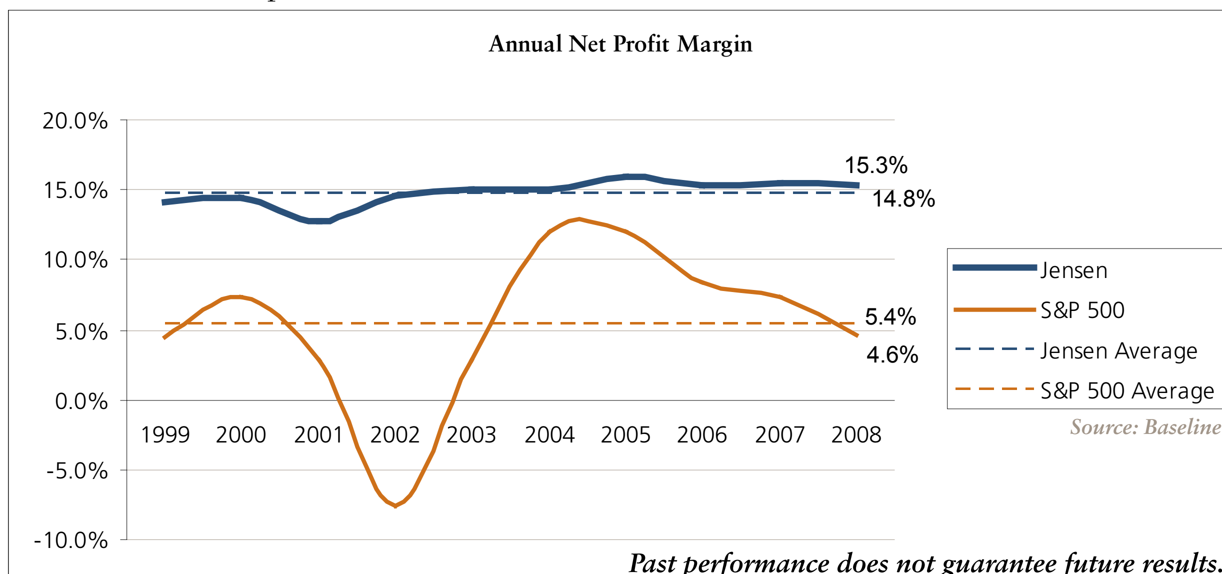
The graph below illustrates the revenue growth of these 28 companies over the last 10 years through December 31, 2008 compared to the companies in the S&P 500 Index for the same period.



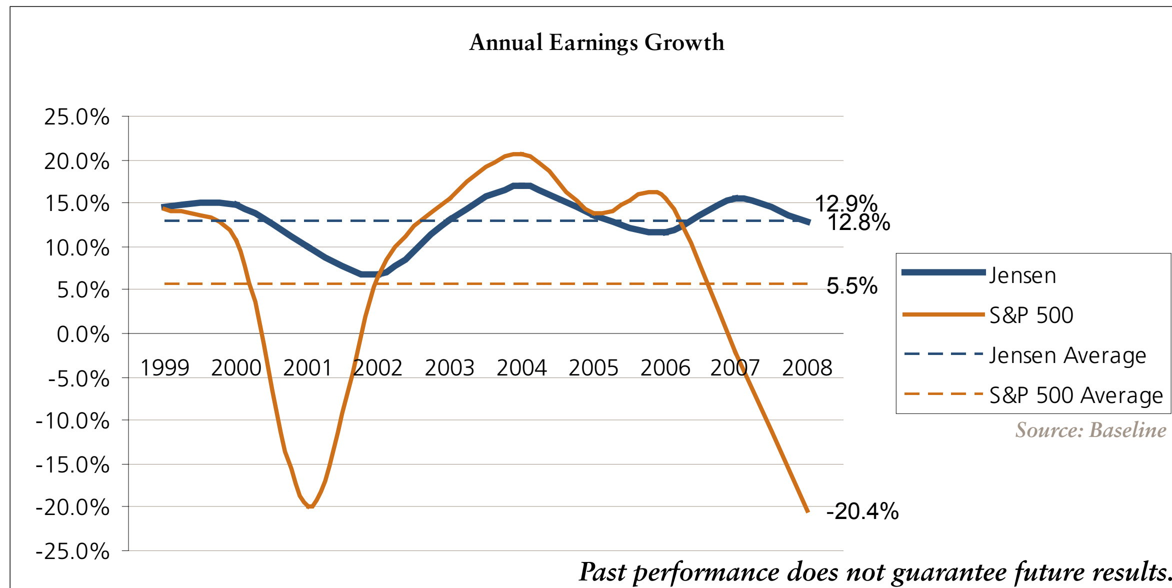
The data show that the revenues of these 28 companies grew 73% faster than the average company in the S&P 500 Index.

High quality companies with strong revenue growth often generate superior profit margins. This performance is usually derived from their competitive advantages which provide stronger pricing power than their competitors.

The following graph shows the net profit margins of these high quality growth companies. Not unsurprisingly, Jensen's 28 companies sported an average net profit margin over the same past 10 years that is nearly three times the average net profit margin of the constituent companies in the S&P 500 Index over the same period.

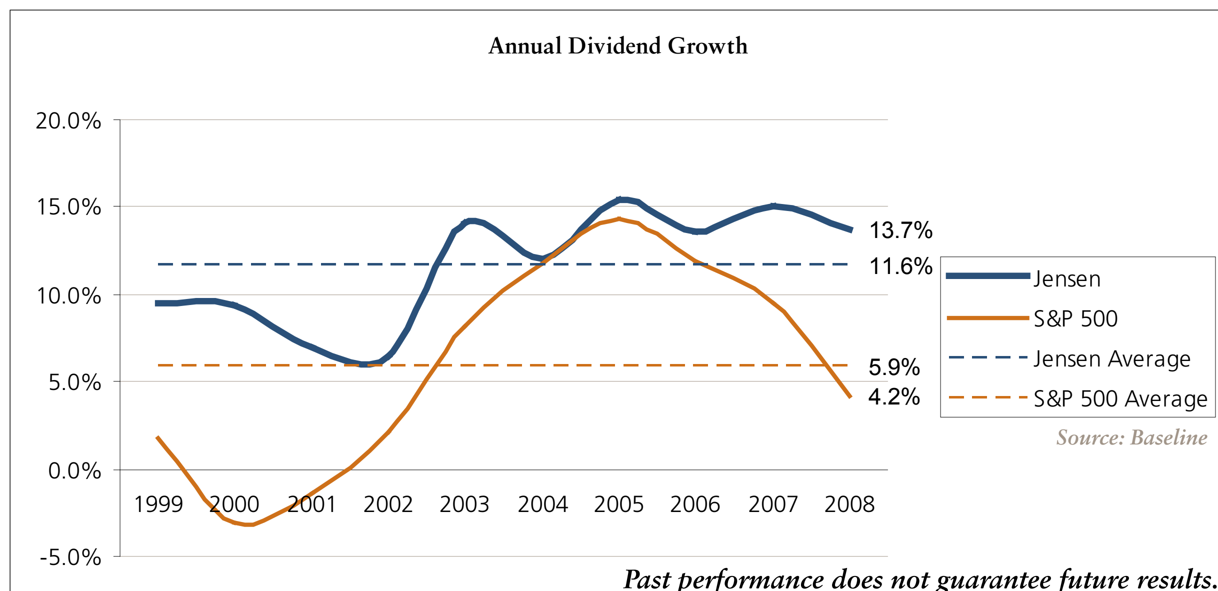


Superior sales performance and robust profit margins contribute to solid earnings per share (EPS) growth. The next graph illustrates the EPS growth for Jensen's 28 companies, which averaged 12.9% over the same past 10 years compared with an average EPS growth for the index companies of 5.5% over the same time frame.



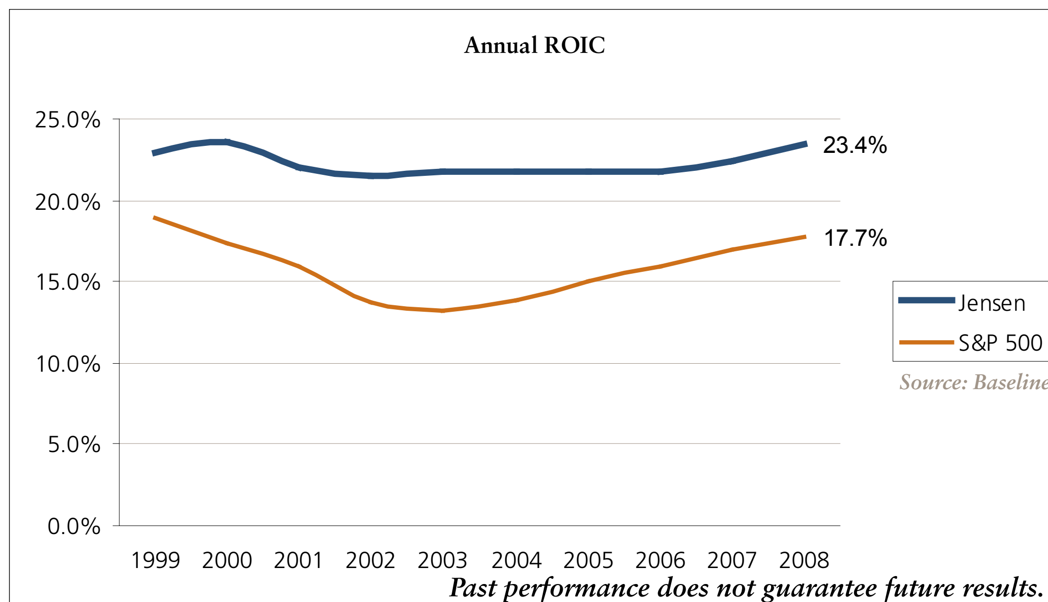
As we all so painfully know, stock markets can be disappointing for long periods. And, yet, many high-quality companies have continued to pay and increase their dividends, even during such challenging times. The graph below shows the 10-year dividend record of Jensen's 28 businesses versus the companies that comprised the S&P 500 Index.

The average dividend growth for these companies over the last 10 years through December 31, 2008 was a healthy 11.6% compared with the average growth in dividends of 5.9% for the companies in the S&P 500 Index.



Central to a company's ability to grow revenues and earnings, maintain high margins and pay a dividend is the company's reinvestment rate, sometimes known as return on invested capital (ROIC).

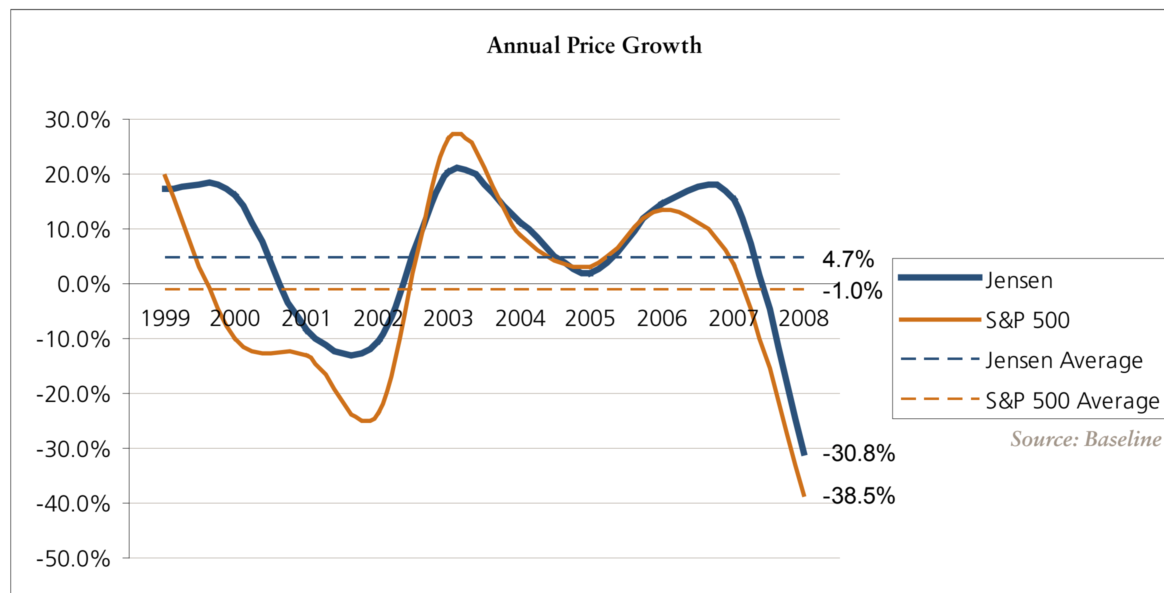
High quality companies typically have above average reinvestment rates. Shown below is the average ROIC for these same 28 companies over the same past 10 years, again versus the constituents of the S&P 500 Index. The average of these companies was 22.3%; most likely well above their cost of capital and considerably higher than the average of the companies in the index.



Past performance does not guarantee future results.

Today, High Quality Companies Appear Attractively Priced

What can we conclude from these fundamentals? Do they drive stock prices? The graph below shows the share price performance of these high quality companies compared to the S&P 500 Index for the 10 year period ended December 31, 2008. Taken as a group, the share prices of these companies increased at an average rate of +4.7%, compared with an average -1.0% (negative) rate of growth of the index.



Past performance does not guarantee future results. The share price performance shown on this chart should not be considered indicative of the historical performance record, or of the future performance, for any current or former client account managed by Jensen, including the Fund.

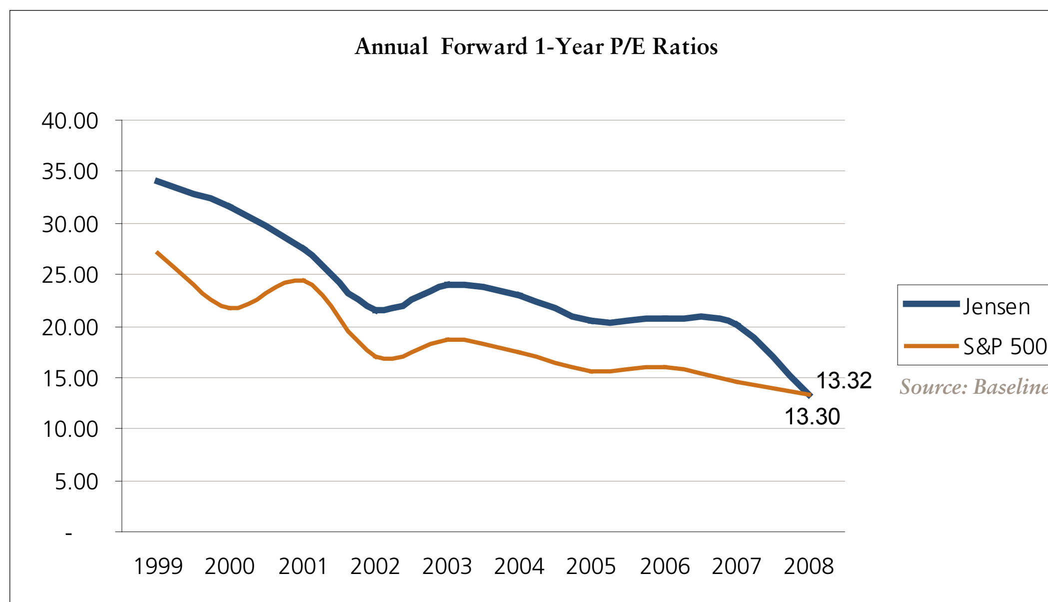
The rate of growth of the share prices of these 28 companies, however, fell significantly short

of the rate of growth of their earnings and dividends, indicating that to us their share prices are currently selling at an attractive level.

The consistency of the fundamentals for Jensen companies, as shown in the first five graphs, has been remarkable when compared with the index companies. High quality, growth stocks usually sell at a premium to the market. Understandably, investors have often been willing to pay a premium for the potential of attractive and consistent growth and the “all-weather” characteristics that can provide important downside protection.

The final graph shows the P/E ratio of this group of companies over the same past 10 years versus the S&P 500 Index. Over the entire period these 28 companies traded at an average premium of 27% to the index (as measured by the weighted average of the leading (forward) one year P/E ratios of the companies at each measurement period).

At the end of the first quarter, March 31, 2009, these high quality growth companies were trading at only a 2% premium to the index, and earlier this year were actually trading at a slight discount to the index’s P/E ratio. As of June 30, 2009, these companies traded at a 10% premium to the index, which we believe supports the premise that they are attractively priced versus the index given their high quality and historical average premium to the index.



Past performance does not guarantee future results. The forward 1 year P/E of a company is a ratio calculated by dividing current price of the stock by the company’s predicted future year earnings per share, as determined by market consensus.

Final Thoughts

Based on this review, and our experiences over the past 21 years, we believe in the power of fundamentals. Assuming reasonable valuations, we believe that an investor’s return should approximate the value creation in a business over time.

Many economists anticipate that the next two to five years will produce below average growth in gross domestic product, deleveraged business and consumer financial statements, rising inflation and interest rates, and more government regulation. We believe there are no companies

better suited to navigate this challenging future economic scenario than high quality growth companies. Although this may not happen each and every year, we believe that companies with above average fundamentals should create more value than lesser-quality companies resulting in superior returns over the long haul.

Much has been written about the "lost" decade of investing, meaning that investors who owned the S&P 500 Index have lost money over the past 10 years. Indeed, those investors who owned average or below-average companies chased speculative stocks, or ignored valuations, may very well have experienced a lost decade characterized by negative returns.

Investors who owned high-quality growth companies may not have experienced the most satisfactory returns during the past 10 years. But we believe that they have experienced a new "found" appreciation of the value of fundamentals and quality businesses. We remain confident that this appreciation should pay off in the future.

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 approximately 20-30 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 June 30, 2009, the Average Annual Total Returns for The Jensen Portfolio - J Shares were -16.24%, -3.57%, -1.84% and 2.35% for the 1-, 3-, 5-, 10-year periods, respectively. As of June 30, 2009 the S&P 500 Index's Average Annual Total Returns were -26.23%, -8.22%, -2.24%, and -2.22% for the 1-, 3-, 5-, and 10-year periods, respectively. The J Shares annual operating expense ratio is 0.85 %.

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.

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 1.800.992.4144, or by visiting www.jenseninvestment.com. Read it carefully before investing.

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 and should not be considered recommendations to buy or sell any security. All factual information contained in this paper is derived from sources which Jensen believes are reliable, but Jensen cannot guarantee complete accuracy. Any charts, graphics or formulas contained in this piece are only for the purpose of illustration.

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. This index is unmanaged and you cannot invest directly in an index.

The NASDAQ Composite Index: is a market capitalization-weighted index that is designed to represent the performance of the National Market System which includes over 5,000 stocks traded only over-the-counter and not on an exchange

Dividend Yield: is a financial ratio that shows how much a company pays out in dividends each year relative to its share price. It is calculated by dividing the dividends paid out in one year by the shares stock price.

Return on Equity: (ROE) Is equal to a company's after-tax earnings (excluding non-recurring items) divided by its average stockholder equity for the year.

Price/Earnings Ratio: The weighted average of the price/earnings ratios of the equity securities referenced. The trailing P/E ratio is calculated by dividing current price of the stock by the company's past year earnings per share. The leading (forward) P/E ratio is calculated by dividing current price of the stock by the company's predicted future year earnings per share, as determined by market consensus.

Earnings Per Share: The net income of a company divided by the total number of shares it has outstanding.

Net Profit Margin: The net income of a company divided by its net sales.

Return on Invested Capital (ROIC): A calculation used to assess a company's efficiency at allocating the capital under its control to profitable investments. ROIC is obtained by dividing a company's after-tax operating earnings (excluding non-recurring items) by its average total debt plus equity capital for the year.

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