Current standardized performance for the Hennessy Small Cap Financial Fund can be found here.

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. Performance data current to the most recent month end may be obtained by clicking here.

Top ten holdings for the Hennessy Small Cap Financial Fund can be found here.

ValueInvestor INSIGHT
The Leading Authority on Value Investing
July 31, 2013

Cleaning Up

The pre-crisis swagger of financial-services firms has largely been replaced by foreboding and caution. That's great news for investors, says Dave Ellison.

INVESTOR INSIGHT

David Ellison
Hennessy Funds

Investment Focus: Seeks companies in the early stages of what's often a long and methodical improvement in their operating execution and/or business environment.

Ask David Ellison how his funds are performing this year against their benchmarks and there's a good chance he won't know. "It's not that I don't care, but it's easy to look at recent performance and think you need to do something," he says. "If that's your reason to act, it's almost never a good idea."

Ellison's reticence to check the score certainly hasn't inhibited his ability to put up great numbers. The Hennessy Small Cap Financial Fund he started in 1997 has earned a net annualized 10.7% since inception, vs. 5.9% for the Nasdaq Bank Index.

Managing small- and large-cap funds focused on financial services, he sees value today in such areas as commercial banks, property/casualty insurers, debt collectors and mortgage servicers.

In nearly 30 years investing in financial-services companies, you've seen the best of times and the worst of times. How would you characterize today's environment?

David Ellison: The banking industry today is basically in good shape, both quantitatively in terms of capital ratios, reserves and loan quality, but also qualitatively in terms of what I call awareness. By that I mean decisions are being made that are long-term, conservative and appropriately mindful of the downside. I cringe when I hear people talk about credit conditions still being too tight, because I think credit conditions are right where they should be. Lenders are underwriting loans that make fundamental sense. The system almost entirely collapsed when that wasn't the case – people want go back to that?

It's a cyclical business. We went up the mountain of risk and complexity and leverage that topped out in 2008, and then the avalanche hit and we're now back down at the bottom of the mountain, reducing risk, reducing leverage, reducing complexity. That's good for everybody and is the best thing that can happen.

When I look back at the 1987 to 1992 credit cycle, when savings and loan companies blew out and it all had to be cleaned up, the best time to buy financials was more or less after it was all over. After cleansing balance sheets and getting into the right mindset, the industry – and the whole economy – went on a great run. The cleanup today is taking longer because we had a bigger down cycle, but I think the same dynamics are at work.

How do you define your opportunity set?

DE: We look for our two funds at all sectors of financial services, across all market caps. That's a universe of 700 or so companies that we track on a regular basis.

Our first cuts are on valuation, specifically price to book value and P/E, but we're also typically looking for change that's underway – at the company or in its business – that would indicate things are going to get better. When you come through a cycle like we just have, the first opportunities – I'm talking here primarily about banks – are for things to go from ugly to OK, usually because new management comes in, stops doing stupid things and sets to work at cleaning up the most pressing problems.

The ideas we're finding now fall more in the category of taking things from OK to good. I liken it to starting at one end of a boardwalk and replacing the boards one at a time as you make your way to the other end. That means going through every business and examining whether it makes sense and then making the tough decisions about what you invest in and what you let go. It's going more from what you need to do in the aftermath of the crisis to what you want to do looking forward. That can be a drawn-out process at the biggest banks, but done well the company is consistently improving itself and that usually is good news for investors.

What non-bank areas are you currently finding of interest?

DE: Certain sectors within the financial services industry are changing dramatically, which can create opportunity. We own mortgage-servicers such as Ocwen Financial [OCN] and Nationstar Mortgage [NSM]. As big banks walk along the boardwalk I described and conclude they don't want to be in the mortgage-servicing business, specialized firms can buy servicing rights and make a nice margin because they have the most-efficient platforms, which only get more efficient as they grow. This is also an area that has tended to benefit when interest rates go up, as refinancings go down.

We also own stand-alone debt-collection companies such as Encore Capital [ECPG] and Portfolio Recovery [PRAA]. Again, their specialization and expertise – here in collecting on bad consumer debts – should allow them to earn a nice spread over what they have to pay lenders who want to get this business off their books. There are cyclical questions here over the supply of new paper and the prices to acquire it, but we're still optimistic about a business like this when the economy is improving, employment is rising and people are more able to pay off their debts.

One other area I'd mention is property/casualty insurance, where in our large-cap fund we've owned AIG [AIG] and MetLife [MET] and more recently added Prudential [PRU] and Travelers [TRV]. AIG is still more a turnaround story, but in general we own the big insurers because they've just gotten too cheap. If we're paying only 70-80% of book value, I'm comfortable these will work out just fine.

How do you respond to the claim that the easy money in AIG has already been made?

DE: One thing I learned originally from Peter Lynch at Fidelity is not to pay any attention to where the stock was, or whether it was a better story, a year ago. AIG is still working through the repositioning of its balance sheet and cost structure. It is still re-establishing its credibility with customers and potential customers. This process is ongoing and there's still plenty of progress that needs to be made. As long as the stock is more than cheap enough relative to book value and earnings, I'm happy to own it.

You don't currently have much exposure at all to investment-management firms. Why is that?

DE: It's been unfortunate at times, but I have to admit I've never been a fan. I see first-hand the big and sometimes nonsensical inflows and outflows that money managers have to deal with, so have decided that investing in companies where that's a constant challenge wasn't for me.

In your analysis of banks, where do you put primary emphasis?

DE: We generally start, at a basic level, with the liability structure of the balance sheet. How much are they borrowing, what are the paying, and what's the duration? How big are core deposits, what do they cost, and what are the sources? In my experience, banks that have the cheapest and most stable borrowings and deposits will be the long-term winners.

Then we look at the assets, with primary focus on the loan mix and track record of underwriting. It happens all the time that when things are good banks

David Ellison

Opportunity Knocks

He's one of the longest-tenured money managers focused on financial services, but David Ellison's initial exposure to the field was pure serendipity. After graduating in 1983 with an MBA from Rochester Institute of Technology, he joined mutual fund giant Fidelity in an operational role, working on information systems used by the investment staff. When famed manager Peter Lynch soon thereafter was looking for an analyst to follow savings and loans, Ellison got the nod. "I had worked summers as a bank teller," he says. "They thought I knew more about the industry than I really did."

By 1985 he had taken over Fidelity's Select Home Finance Fund, which he ran until joining investment bank Friedman, Billings, Ramsey in 1996 to launch its mutual fund business. In October of last year Hennessy Funds purchased the assets of ten FBR funds, leaving Ellison's small-cap and large-cap funds fully in his charge.

Among the insights learned from his time with Peter Lynch: Don't sweat the small stuff. "I'd complain about this earnings report or that comment from the CEO and he'd always ask, 'Is the business still getting better?' If it was and you could explain why, that's all he usually wanted to know."

overdo it in certain areas, like construction loans, that end up causing great pain when things aren't so good. Typically the more balance across loans and other investments, the better.

In our models we look at the companies sequentially by quarter, not year over year. It's maybe a little thing, but there's not much seasonality in the business and we've found this helps us see the trends in loan growth or margins or deposits more quickly and clearly.

You're describing what sounds like a run-of-the-mill bank that is far less complicated than large banks have become. Is there an argument that big banks are just too hard to understand?

DE: I'd argue that most of the basics hold whether you're looking at a big or small bank, but that is a valid concern. An industry this important to the health of the economy should not be one that investors are afraid of because they don't understand it. Opaqueness is there and that's a problem with the system, but the good news is that companies – either by external pressure or by acting in their own self-interest – are becoming less opaque. As I said earlier, a healthier banking system is run with a broad level of conservatism and long-term vision. A result of that is less complexity.

This highlights the importance of management in assessing any bank's prospects. I can cite way too many stories where the CEO of a bank with $3 billion in assets goes on an acquisition spree and five years later the bank has $12 billion in assets, but the book value per share has gone from $12 to $8 and the stock has fallen from $15 to $10. The CEO may be happy because he's paid on the level of assets, but shareholders aren't.

What you need to understand, for want of a better word, is the demeanor of the top three or four people running the bank. Are they pushing growth for growth's sake, which is almost always a bad idea? You want to be sure they fully understand the environment, have a thoughtful attitude toward risk, and are clearly focused on increasing shareholder value. Part of that is assessing character, which comes from meeting them and listening carefully to what they say. Part of that is tracking in the numbers what they've done and what they're doing.

There are a lot of things that need to be done in this business to make it more profitable, from better managing headcount, to utilizing technology, to remaking asset and liability structures. Big banks in particular need to be fundamentally redone over the next four or five years, in what's sure to be a changing interest-rate, regulatory and housing environment. If I own the best managers, I'm quite confident that in such an evolving environment they're going to be taking an ever greater share of industry profits.

ON BANK REGULATION:

If the economy is healthy, I'm not that worried that banks won't find plenty of opportunity to make money.

Let's talk about some macro issues. What happens to banks if interest rates rise?

DE: Don't tell me what rates are going to do, tell me why they're doing it. If interest rates go up because we're Greece, that would obviously be a big problem for banks and the entire economy. The situation in Europe has made it pretty clear that an unlimited amount of sovereign debt will eventually hurt you.

If rates go up because the economy is getting stronger and there's a bona fide demand for credit that is driving loan demand, that's good for banks because they'll have loan growth. Yes, deposit costs go up, but almost every bank is sitting on a tremendous amount of liquidity. Last time I looked at JPMorgan, something like 25% of its assets were earning next to nothing. Those assets are financed with debt that's paying something, so they're earning a negative spread. If they can turn that spread to positive by putting money toward new loans, that's a big plus. The same is true at smaller banks, which are sitting on comparable levels of cash. Ultimately, rising rates and a steeper yield curve should be good for bank stocks.

Coming back to management, you want to know how they're preparing for rates starting to go up. What's happening to the duration of their loans? How are they preparing the liability side of the balance sheet? What you don't want to hear is that they don't expect rates to go up so aren't worried about it. That's speculating, not managing.

Some investors worry that new regulations will turn banks into regulated utilities. How do you think about that?

DE: While there have been a few things on the regulatory front that are disappointing, at the end of the day the effort to better protect the integrity of the system is a good thing. I think the financial system is too big in this country and in much of the world. Banks shouldn't be relied upon for creating growth, but for enabling it and making it more durable through making intelligent loans.

The best companies are going to manage to what's going on. If new rules make this or that tertiary business unprofitable, they'll stop doing it. If the economy is healthy, I'm really not that worried that banks won't be able to find plenty of opportunity to make money.

How generally do you look at valuation?

DE: I keep it relatively simple, focused on cheapness relative to book value and earnings. That of course requires vetting the validity and safety of those book values and making adjustments as necessary. It also requires assessing the quality and sustainability of earnings and whether adjustments need to be made from the current-run-rate levels I typically use.

I put a lot of emphasis on the connective tissue between earnings and growth in book value. If a company makes $1 per share and pays a 20-cent dividend, I want the book value per share to grow 80 cents.

If that isn't happening, I need to understand why. If there's a chronic issue with things like intangibles writeoffs or dilutive capital allocation, that's a big red flag.

To make the math easy, if a bank is going to earn 10% on equity after tax and dividends, they're going to grow book value at 10% per year. If I can buy the stock at, say, 1.2x to 1.5x book, that valuation may wobble but probably won't change that much over time. So you've got a stock that should go up 10% per year. If half my portfolio can do that, that's a pretty good base upon which to build.

Turning to some specific ideas, describe your interest in Florida-based BankUnited [BKU]?

DE: This was a high-profile casualty of the financial crisis that was seized by regulators in 2009 after making way too many bad loans, many of which were made to people from outside the U.S. who wanted to buy property in Florida. The operations were sold to a private-equity group, with the government essentially agreeing to absorb future losses on most of the assets acquired. The company came public again in early 2011.

One key attraction for me is the Chairman and CEO, John Kanas, who came along with the private-equity deal and whom I've invested alongside in the past. He's a proven operator with a long-track record of success, most prominently in building Long Island's North Fork Bancorp before selling it to Capital One in 2006. He's been going step by step through the boardwalk I alluded to earlier, to the point where the company is very well capitalized and all the metrics are moving in the right direction.

Our basic thesis is that with the business improving, no asset-quality worries and top-tier management, BankUnited is well positioned to take advantage of an economic recovery in Florida. Most of its footprint is around Miami, which is the most-populous part of the state and the area most likely to lead any sustained economic revival. The bank isn't so big – with $13 billion in assets – so there is plenty of room to grow either organically or through acquisition. They could double assets without needing to raise any additional capital.

With the stock at $30, how are you looking at valuation?

DE: The stock today trades at around 160% of book value. Earnings are a little quirky because of the government guarantees, but there's no reason over time that BankUnited can't earn a return on equity that translates into book-value growth at least in the low double digits.

More interesting is if the assets grow as we believe they can. It's not a big stretch to imagine the company doubling in size, which could double earnings, which – given that the valuation is low enough – would probably have a pretty nice impact on the stock price.

Is there a takeout story here?

DE: In general, I think people overemphasize consolidation stories. If you own the companies that are doing the right things, you'll win in the end regardless.

That said, there is scarcity value here in

INVESTMENT SNAPSHOT

BankUnited
(NYSE: BKU)

Business: Provider of a wide range of commercial and consumer banking services primarily in south Florida, where it is based and operates nearly 100 branches.

Share Information
(@7/30/13):

Price	**30.05**
52-Week Range	22.01 – 30.42
Dividend Yield	32.8%
Market Cap	$3.02 billion

Financials (TTM):

Revenue	$685.6 million
Operating Profit Margin	56.6%
Net Profit Margin	31.3%

Valuation Metrics
(@7/30/13):

	BKU	Russell 2000
P/E (TTM)	14.5	48.8
Forward P/E (Est.)	16.9	18.7
Price/Book Value	1.6	

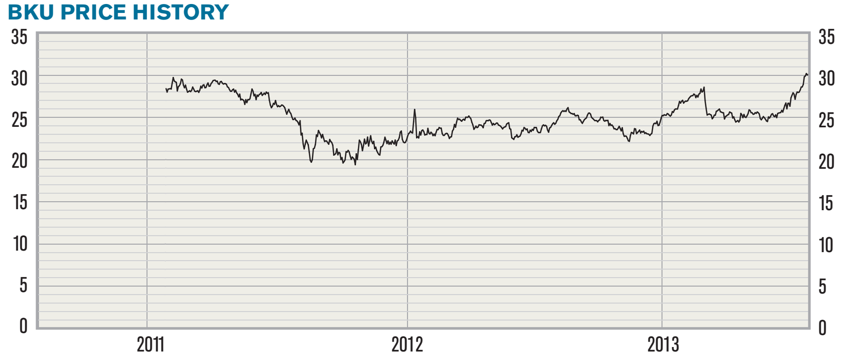
Largest Institutional Owners
(@3/31/13):

Company	% Owned
Wellington Mgmt	9.7%
Carlyle Group	8.7%
T. Rowe Price	8.6%
Blackstone	8.1%
Invesco	8.1%

Short Interest (as of 7/15/13):

Shares Short/Float	1.9%

BKU PRICE HISTORY



THE BOTTOM LINE

A casualty of the financial crisis, the company now has no asset-quality worries and is well positioned to take advantage of a Florida economic recovery, says David Ellison. It has both the management and capital capacity to double in size, he says, which given the shares' current valuation, "would probably have a pretty nice impact on the stock price."

Sources: Company reports, other publicly available information a smallish, well-located bank in the third most-populous state in the country. The CEO has shown an ability to make money both in a slow and steady way and in one fell swoop by selling out. I'm confident he'll choose the right path at the right time here as well.

Is the basic story fairly similar for Washington state's Sterling Financial [STSA]?

DE: One thing fairly unique to banking is that the stories often are fairly similar. Today I own several smallish banks that nearly died in the crisis, had to be recapitalized, and are now on the mend under more prudent management. I don't know which one is going to perform the best in the stock market over the next six months, but I'm happy to own a bunch of them.

Sterling is based in Spokane, Washington, with almost $10 billion in assets and 174 branches located mostly in the Pacific Northwest. Prior to the crisis it made too many bad home and construction loans and then ultimately had to raise a considerable amount of capital both from the federal government and private equity before it could get itself back on track.

The story is similar to BankUnited in that there is competent management that has cleaned up the bank and focused it on improving earnings metrics. It also has plenty of capital – the capital ratio is around 12% – to fund growth in an attractive region of the country.

People ask me if a bank like this is doing anything special and I say that's exactly what you don't want to see. I'm not interested in the bold and unique strategy. I just want to hear about making basic loans with solid underwriting requirements, funded by basic deposits and earning a basic spread. If we learned anything from the crisis, it's that exciting and new don't work out so well in banking. This is a get-rich-slowly industry. Investors may not always like that and CEOs may not always have the patience for it, but that's the way it is.

Do you have a get-rich-slowly outlook for the stock price, now around $26?

DE: The stock trades today at about 130% of book value, so you're not paying a premium for a healthy balance sheet and a management team that is aware of the environment and fully capable of taking advantage of the opportunities ahead. If I eventually get an additional kick from the valuation expanding, great, but I'm certainly okay without it.

What's your investment case for Puerto Rico's First BanCorp [FBP]?

DE: This idea actually is unique in that First BanCorp is one of the few names left that is more of a BankUnited or Sterling Financial from three years ago. Nonperformers are high – 9% of assets – and writeoffs have been more or less consuming solid operating profits for the past six quarters. One positive difference is that the company has a 9% capital ratio, so it has plenty of staying power and can resume growth without having to raise new money once the balance sheet is in order.

This is basically a credit-cycle story. The Puerto Rican economy is behind ours in terms of recovery, but it's benefitted from our policies here and things are

INVESTMENT SNAPSHOT

Sterling Financial
(Nasdaq: STSA)

Business: Holding company whose principal operating subsidiary is Sterling Savings Bank, a state-chartered commercial bank based in Spokane, Washington.

Share Information
(@7/30/13):

Price	**26.04**
52-Week Range	19.46 – 27.51
Dividend Yield	3.1%
Market Cap	$1.62 billion

Financials (TTM):

Revenue	$497.2 million
Operating Profit Margin	39.0%
Net Profit Margin	20.5%

Valuation Metrics
(@7/30/13):

	STSA	Russell 2000
P/E (TTM)	16.1	48.8
Forward P/E (Est.)	16.7	18.7
Price/Book Value	1.3	

Largest Institutional Owners
(@3/31/13):

Company	% Owned
Thomas H. Lee Partners	20.8%
Warburg Pincus	20.8%
Wellington Mgmt	9.8%
Capital World Inv	4.7%
Fidelity Mgmt & Research	3.4%

Short Interest (as of 7/15/13):

Shares Short/Float	3.3%

STSA PRICE HISTORY

THE BOTTOM LINE

Leery of any "bold and unique" strategies, David Ellison is pleased that the company is "making basic loans with solid underwriting requirements, funded by basic deposits and earning a basic spread."

Sources: Company reports, other publicly available information

INVESTMENT SNAPSHOT

First BanCorp
(NYSE: FBP)

Business: Diversified commercial banking services focused primarily on Puerto Rico, with branch offices also in Florida and the U.S. and British Virgin Islands.

Share Information
(@7/30/13):

Price	**7.66**
52-Week Range	3.34 – 8.70
Dividend Yield	0.0%
Market Cap	$1.59 billion

Financials (TTM):

Revenue	$234.1 million
Operating Profit Margin	(-28.5%)
Net Profit Margin	(-69.0%)

Valuation Metrics
(@7/30/13):

	FBP	Russell 2000
P/E (TTM)	n/a	48.8
Forward P/E (Est.)	13.0	18.7
Price/Book Value	1.4	

Largest Institutional Owners
(@3/31/13):

Company	% Owned
Thomas H. Lee Partners	24.6%
Oaktree Capital	24.6%
Wellington Mgmt	9.2%
Fidelity Mgmt & Research	4.6%
BlackRock	2.5%

Short Interest (as of 7/15/13):

Shares Short/Float	6.0%

FBP PRICE HISTORY

THE BOTTOM LINE

While most U.S. banks are further along in the credit-quality recovery process than this Puerto Rico-based one, it is very well capitalized and earning solid pre-writeoff profits, says David Ellison. If he's right that normalized earnings are around $1 per share, today's less than 8x P/E multiple on that estimate "should turn out to be awfully cheap," he says.

Sources: Company reports, other publicly available information

getting better. As non-performing assets come down, earnings should improve, which may happen fairly quickly with a more positive tailwind from the economy than BankUnited, say, had three years ago.

Your focus ideas so far are banks that got capital infusions from private-equity firms – in First BanCorp's case from Oaktree Capital and Thomas H. Lee Partners, both of which remain major shareholders. Does that in any way play into your interest?

DE: We like to see other successful investors share our enthusiasm, and to the extent their continued involvement means shareholders' interests remain front and center, that's a good thing. But that's not at all the reason we own these. We own them because you have new management that is paying attention, having taken over from old management that wasn't paying attention.

The stock, now at $7.65, has more than doubled over the past year. What upside do you see from here?

DE: They won't work through the overhang of bad loans overnight, but we think normalized earnings here are somewhere in the range of $1 per share. So you're paying a less than 8x P/E on that at the current price. If we're right that earnings rebound and book value starts growing again, that should within a couple years turn out to be awfully cheap.

Explain why Citigroup [C] is your largest big-bank holding.

DE: As I described with the smaller banks, I'm not making a big distinction right now between the opportunity in a Citigroup or a JPMorgan Chase [JPM] or a Bank of America [BAC], all of which we own at similar position sizes. In all of these cases, you're looking at huge opportunities to better maximize the yield on assets, minimize the cost of liabilities, and reposition or reorient headcount to more fully take advantage of profit opportunities ahead. Earnings are becoming safer as companies reduce risk, leverage and complexity on the balance sheet. You also don't have to rely on organic growth, as there is plenty to work on to improve the profitability of each business as is. I may weed names out as it becomes clearer what the individual companies are doing, but for now I'm taking more of a group-hug approach.

Citigroup has been working through the worst of its assets – mostly housed in what it calls Citi Holdings – and there is probably another year of cleaning things up before we can start talking about material growth in book value again. But the real work is just starting on the blocking and tackling I think needs to be done. Here you can run all kinds of spreadsheets and what-ifs, but in the end it's not a question of math, but whether you have confidence in management to make reasonable, long-term-oriented decisions. With Citi under its current chairman [Michael O'Neill] and CEO [Michael Corbat], I do. For a company that spent so many years accumulating things, the potential leverage from intelligently paring it back is pretty impressive.

Can you put some numbers on that?

INVESTMENT SNAPSHOT

Citigroup
(NYSE: C)

Business: Diversified bank holding company with some 200 million customer accounts and operating in more than 160 countries and jurisdictions.

Share Information
(@7/30/13):

Price	**51.78**
52-Week Range	26.00 – 53.56
Dividend Yield	0.1%
Market Cap	$157.46 billion

Financials (TTM):

Revenue	$63.67 billion
Operating Profit Margin	18.9%
Net Profit Margin	15.2%

Valuation Metrics
(@7/30/13):

	C	S&P 500
P/E (TTM)	16.6	18.6
Forward P/E (Est.)	9.3	15.1
Price/Book Value	0.8	

Largest Institutional Owners
(@3/31/13):

Company	% Owned
Vanguard Group	4.3%
State Street	4.0%
Fidelity Mgmt & Research	3.2%
BlackRock	2.7%
Capital World Inv	2.5%

Short Interest (as of 7/15/13):

Shares Short/Float	1.2%

C PRICE HISTORY

THE BOTTOM LINE

With the crisis largely behind it, the company now must be "fundamentally redone" in order to focus its strategic initiatives and improve profitability, says David Ellison. If management executes as he expects and earnings within a couple of years push $7 per share, he believes shareholders at today's stock price will be more than amply rewarded.

Sources: Company reports, other publicly available information

DE: Earnings follow the balance sheet. Balance sheets pre-crisis deteriorated before earnings did. Now that the balance sheet has gotten better for a couple of years, barring some calamity in the economy, earnings are likely to catch up.

If you're right, today's share price of $51.75 doesn't appear particularly dear.

DE: Today's price is less than book value and just over 9x forward earnings. If book increases to $60 per share, say, in two years, and earnings rise like we believe they can, we've got upside both from growth and from likely multiple expansion.

What is the market missing here?

DE: There could be some concern that the economy isn't going to keep getting better, but I think it's mostly a question of impatience. People want this to be a better company now, not a year from now and then again the year after that.

You asked whether the easy money had been made in AIG and you could ask the same with Citigroup. I remember coming out of the 1991-92 down cycle and people telling me after Citi shares had gone from $12 to $20 that there wasn't anything left to get better and that all the upside was in the stock. When I was selling at $120, it was pretty obvious it hadn't all been in the stock. I'm certainly not predicting the same thing happens again, but I do believe this story has a lot further to run.

In our last issue, Brian Bythrow of Wasatch Advisors recommended Internet bank BofI Holding [BOFI]. Is something like that on your radar screen?

DE: I've looked at the public Internet banks but can't say that I've formed a particularly strong opinion. The business model makes sense, but the bigger question today is valuation. For the time being I've been finding enough opportunities with traditional banks that I know very well, so haven't found the need to look very far afield.

You outperformed in your small-cap fund the Nasdaq Bank Index by an average of 1400 basis points per year from 2007 to 2009. You were still down, but what did you do right?

DE: Having been through the 1987-1992 cycle, it's etched in my mind that the real destroyer of value in this industry is the deterioration of credit. So once non-performing loans started to go up across my portfolio companies, I started to sell. I didn't sell everything, but by mid-2008 I had roughly 60% of the small-cap portfolio in cash. As the floor came in on credit deterioration, I started putting money to work when a lot of people were still scared to death of banks.

Another lesson I learned from Peter Lynch is that when things are getting better you want to buy them and when things are getting worse you want to sell them. That's what I did – it was fairly mechanical.

How much cash are you holding now?

DE: We've been at 5% or less. Non-performers are declining and for most companies things are getting better. I could certainly go to 60% cash again, but I hope I retire before I need to.

Like anyone in the business for 30 years, you've been through some pretty rough patches. Does dealing with the mental side of that get easier over time?

DE: I don't know if it's easier, but my temperament generally is to avoid getting overly excited when things are going my way or overly worried when things aren't. It may sound kind of basic, but what's most important there is that you truly understand what you own and why you believe it's going to get better. When that hasn't been the case, because I wanted to get in on some trend or new way to make money, it's never worked. We all have the instant-gratification gene, but I've been fairly successful in suppressing mine when it comes to investing. VII

Important Disclosures

Investors should consider the investment objectives, risks, charges and expenses carefully before investing. This and other important information can be found in the Fund's statutory and summary prospectuses. To obtain a free prospectus, please call 800-966-4354 or visit www.hennessyfunds.com. Please read the prospectus carefully before investing.

Mutual fund investing involves risk; Principal loss is possible. A non-diversified fund, one that may invest its assets in fewer holdings than a diversified fund, is more exposed to individual stock volatility than a diversified fund. Investments focused in the financial services industry may be adversely affected by regulatory or other market conditions such as rising interest rates. The Fund invests in smaller companies, which involves additional risks such as limited liquidity and greater volatility. Because the Fund focuses on financial services companies that may invest in real estate, the Fund is subject to the risks associated with ownership of real estate and the real estate industry such as fluctuation of real estate values, changes in economic conditions, interest rates and government actions.

NASDAQ Bank Index is a capitalization weighted index of domestic and foreign common stocks of banks that are traded on the NASDAQ National Market System. **S&P 500 Index** is an unmanaged index commonly used to measure the performance of U.S. stocks. **Russell 2000 Index** is an unmanaged total return index of the smallest 2000 companies in the Russell 3000 Index, as ranked by total market capitalization. One cannot invest directly in an index. Fund holdings and sector weightings are subject to change and should not be considered a recommendation to buy or sell any security. **Price/Earnings Ratio** is the market price per share divided by earnings per share. **Price/Book Ratio** is the market price per share divided by book value. **Book Value** is the value at which an asset is carried on a balance sheet. **Duration** is a measure of the price sensitivity (the value of principal) of a fixed-income investment to a change in interest rates. **Forward Price/Earnings Ratio** is a measure of the price-to-earnings ratio using forecasted earnings for the P/E calculation. **Capital Ratio** measures a bank's financial stability. The higher the ratio the more sound the bank.

Past performance is no guarantee of future returns.