

Tech stocks off the beaten path

Zach Shafran looks in unconventional places for science and technology stocks, generating steady returns for investors.

By Mina Kimes, writer-reporter

NEW YORK (Fortune) — If you only look at its performance so far this year, Ivy Science & Technology, which has \$1 billion in assets, doesn't look terribly impressive.

Other technology funds have soared, topping all Morningstar categories and returning an average of 52% so far this year; Ivy Science & Tech (WSTAX), on the other hand, has risen just 32%, which places it in the bottom 3% of its category.

The fund's long-term performance, however, tells a different story: Over the last three years, it has returned about 6%, beating the S&P 500 by 11 points and landing in the top 1% of all technology funds. Ivy Science & Tech has returned 9% over the last five years, while the index has been flat.

Technology funds are often high-risk investments, but Ivy Science & Tech, which is managed by Zach Shafran, is a steady performer with relatively stable returns.

True, the fund has lagged in the rebound, but it beat its peers by 18 points last year, and 17 points in 2002 after the tech bubble burst. That's because Shafran's portfolio is much more diversified than most technology funds, with large holdings in health care, consumer staples, and industrial stocks, as well as cash.

"We're looking for companies that are utilizing science and technology to dramatically change what they do," says Shafran.

The guiding theme behind the fund isn't Internet services or software but innovation — companies that reinvent themselves and their industries. That approach has led Shafran out of the traditional technology sector and into stocks like agribusiness giant Archer Daniels Midland (ADM, Fortune 500), which he sees as an alternative energy play. "From a sustainability standpoint, we're interested in what they're doing with biomaterials," he says.

Shafran also invests in drug companies that he views as technological innovators. Those include Vertex Pharmaceuticals (VRTX), which has a late-stage hepatitis drug, and Amgen (AMGN, Fortune 500), a biotech that is awaiting approval from the FDA for an osteoporosis treatment. "Amgen has been around a long time, but it's growing and it's poised to do better," says Shafran.

While many technology investors are focused only on growth, Shafran picks stocks with an eye for valuation — the average holding in his portfolio has a price to earnings ratio of 15, which is slightly cheaper than the S&P 500. "We look for where there's an opportunity for a change in perception," he says.

As an example, Shafran points to Alliance Data Systems (ADS), which makes private label credit cards. "People look at that and say it's a bad business, not a technology business," he says. "That's the wrong way to think about it — the company is about data." Alliance Data Systems handles loyalty programs for its clients, collecting and analyzing consumer information — a service that Shafran thinks more companies will use going forward.

Shafran likes companies that provide technology to non-tech sectors, which is why Aspen Technology, which sells software for process manufacturing to the chemical and petroleum industries, is one of his top holdings.

Aspen is a turnaround bet: "If you think about all of the things that could go wrong, it's happened to them," says Shafran. "Management cooking the books, fraud, no operation controls. But they've got new management and they've turned the ship around." The stock was dropped from NASDAQ, because it failed to meet the exchange's transparency standards, and is now traded on the Pink Sheets.

Ivy Science & Tech's wide mandate has enabled Shafran to pick up shares of lesser known stocks like Telvent (TLVT), a Spanish maker of real-time operating software for industrial businesses and utilities. "Their software controls 50% of all of the hydrocarbon movement in this country," he says. "They're infusing an enormous amount of technology into the global infrastructure."

While Telvent's products are pervasive, says Shafran, its stock has yet to gain the attention of the common investor. "Most people have never heard of them, which we like," he says.



COURTESY: IVY FUNDS

Zach Shafran, manager of Ivy Science & Technology, looks for companies that reinvent themselves and their industries.

Ivy Science and Technology Fund Performance as of 06/30/10

SHARE CLASS	QUOTRON	INCEPTION DATE	1-YEAR	3-YEAR	5-YEAR	10-YEAR	LIFE	EXPENSE
Class A (NAV)	WSTAX	07/03/00	10.24%	0.13%	6.52%	—	1.71%	1.50%
Class A (Load)	WSTAX	07/03/00	3.90%	-1.83%	5.26%	—	1.11%	1.50%
Class C (NAV)	WSTCX	07/31/97	9.40%	-0.65%	5.65%	1.00%	10.98%	2.30%
S&P North American Technology Sector Index	—	—	15.84%	-4.26%	3.06%	-8.11%	—	—

Data quoted is past performance and current performance may be lower or higher. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, and shares, when redeemed, may be worth more or less than their original cost. Please visit www.ivyfund.com for the Fund's most recent month-end performance. Class A share performance, including sales charges, reflects the maximum applicable front-end sales load of 5.75 percent. Performance at net asset value (NAV) does not include the effect of sales charges. Class A share performance, including sales charges, reflects the maximum applicable front-end sales load of 5.75%. For Class C shares, a 1% CDSC applies to the lesser of amount invested or redemption value of shares redeemed within twelve months after the purchase date. For Class C shares, performance prior to 3/24/00 is based on the fund's original Class B shares, which were combined with Class C Shares, effective 3/24/00, and redesignated as Class C shares. New Class B shares with fees and expenses different than the original Class B shares were added to Ivy Funds on 06/30/00. S&P North American Technology Sector is an unmanaged index comprised of securities that represent the technology sector of the stock market. It is not possible to invest directly in an index.

For each fund with at least a 3-year history, Morningstar calculates a risk-adjusted return measure that accounts for variation in a fund's monthly performance (including the effects of all sales charges), placing emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund and rated separately.) A fund's Overall Rating is derived from a weighted average of the 3-, 5- and 10-year (if applicable) rating metrics. Morningstar Rating is for the share class specified; other classes may have different performance characteristics. Morningstar, 06/30/10. The Fund received five-star overall rating. The Fund received a five-star rating for the 3-, 5-, and 10-year periods. Technology category: 186 funds overall, 186 funds in the last three years, 177 funds in the last five years and 116 funds in the last ten years.

Consider All Factors. As with any mutual fund, investment return and principal value of an investment will fluctuate, and shares, when redeemed may be worth more or less than their original cost. Investing in companies involved in a specified sector may be more risky and volatile than an investment with greater diversification. These and other risks are more fully described in the Fund's prospectus. Not all funds or fund classes may be offered at all broker/dealers.

Investors should consider the investment objectives, risks, charges and expenses of a fund carefully before investing. For a prospectus containing this and other information for the Ivy Funds, call your financial advisor or visit us online at www.ivyfund.com. Please read the prospectus carefully before investing.

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Top 10 Equity Holdings ¹	
(as a % of net assets as of 06/30/10)	
Apple, Inc.	5.4%
Alliance Data Systems Corporation	5.2%
Cree, Inc.	5.0%
Aspen Technology, Inc.	4.5%
Microsoft Corporation	4.4%
Texas Instruments, Inc.	3.1%
ACI Worldwide, Inc.	3.1%
Vertex Pharmaceuticals, Inc.	3.0%
Lawson Software, Inc.	3.0%
Genzyme Corporation	3.0%

¹Information is subject to change and is not intended to represent any past or future investment recommendations.

Not FDIC/NCUA insured	May lose value	No bank guarantee
Not a deposit	Not insured by any federal government agency	

