

Down But Not Out

Two downtrodden funds that are poised for a turnaround

BY JORDAN BENINCASA

If you've been watching your mutual funds go down recently, join the club. A number of our favourite actively managed offerings have also seen better days. However, bailing out now is probably not the wisest decision, especially if you are basing it on lacklustre performance. Just remember, very few money managers, if any, can produce stellar results year in, year out.

Yet there's nothing wrong with a watchful unitholder trying to figure out why a fund performed as it did even over shorter stretches. After all, doing so can help investors better understand the fund's strategy and how that approach responds to various market conditions. And in some situations a look at poor short-term performance can lead to the discovery of deep-rooted problems that make the fund less attractive to own.

In the case of CI Value Trust and Brandes Global Equity, an investigation of their short-term numbers yields interesting results. We think each of them has a reasonable explanation for the disappointing recent performance, and that there's reason to believe an improvement could be on the way.

CI VALUE TRUST

CI Value Trust has taken its lumps recently. Its 33% loss over the 12 months ending March 31 is among the worst performances in the U.S. Equity category. While this fund is clearly not for the faint of heart, it remains among our favourites.

Many of the traits that have led to such a dismal showing are the same ones that have made lead manager Bill Miller a legendary stock picker. And to have the opportunity to participate in the type of upside that Miller is capable of, investors have to live with the risks of his approach. That said, none of the investments that have led to these significant losses are inconsistent with Miller's investment philosophy.

Unfortunately, nothing seems to be going right for Miller lately. For one, modest bets on stocks with ties to a struggling U.S. real estate market like mortgage lender Countrywide Financial and homebuilder Centex Corp. have gone from bad to worse. Secondly, a lack of energy names has caused the fund to miss out on that sector's latest rally. And adding insult to injury, negative currency movements have

also hurt performance.

But Miller's biggest public wart was the fund's position in investment banking firm Bear Stearns, which saw its share price plummet 88% during the first quarter of 2008. Thankfully, there could be a silver lining here. Banking rival JPMorgan Chase, the fund's third largest position at roughly 5% of assets, has agreed to acquire the now struggling investment giant at what many analysts consider a fire sale price. Miller's team believes that JPMorgan's stock should greatly benefit from this purchase over the long term.

Miller has not wavered from his investment discipline. In fact, escalating turbulence in the financial sector has given him the opportunity to invest in companies in which he sees sustainable competitive advantages, such as Freddie Mac and Merrill Lynch.

This is not the first time Miller has made bold investment moves. For example, after the technology bubble burst in 2002, he was buying tech stocks. That move played out well as tech holdings have racked up sizable gains in recent years.

We are also comforted by Mill-

er's superb track record on Legg Mason Value Trust, a fund sold in the United States on which the CI offering is based. That fund has delivered some impressive returns, consistently outperforming the S&P 500 Index over a span of two decades. We don't believe that one bad year of performance means that Miller's investment acumen has simply disappeared.

BRANDES GLOBAL EQUITY

As of late, this fund has run into a brick wall. It's down 25% over the past 12 months and trails the median fund in the Global Equity category and the MSCI World C\$ Index by 12.9% and 11.5%, respectively. Clearly, the stocks this fund owns haven't made for a desirable portfolio over the past year.

Although performance has been disappointing, Brandes's investment decisions were driven by the same process that has led to outstanding returns in the past, such as this fund's 48% one-year return as of March 2004. That's why we look at all periods of performance to see how a manager's strategy plays out in various market environments. If a fund is capable of producing outsized returns, it is likely capable of falling deep into the red too.

The Brandes team approaches tumultuous times dispassionately and puts analysis ahead of fear when investing. So, it hasn't been scared off by the market's volatility

or its own missteps. For example, instead of sitting back and waiting for beleaguered positions to turn around, the team has been aggressively buying into price weakness. Trying to catch a falling knife will likely cause the fund to incur volatility in the short term, but a key to the firm's success has been its conviction in its investment process.

Brandes's investment team abides by a deep-value investment philosophy, believing that the market misprices securities frequently, and sometimes radically. The managers require a deep discount to their estimated intrinsic value (i.e. a sufficient margin of safety) for each new holding, which normally occurs when a company's stock has been battered by bad news. As a general rule, the stocks with the largest margin of safety will receive a higher allocation in the fund.

With this strategy, we believe the fund can outperform its benchmark and category peers over the long term. Using the same approach, Brandes has established admirable long-term track records on many of its institutional accounts as well as mutual funds it managed for AGF Management Ltd. prior to launching this and other retail offerings under its own moniker in 2002.

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