

MUTUAL FUNDS QUARTERLY REVIEW

OUT OF THE GATE | By Lyneka Little

From Small-Cap Value to a Twist on Asia: Four Mutual Funds That Flew Under the Radar

Amid the thousands of stock mutual funds, new entrants can get overlooked, even as they offer smart approaches and some rack up strong early returns.

We asked fund analysts and financial advisers to point out some noteworthy fledgling funds. Here are several from their lists. Two of the funds focus on dividend-paying stocks, but from different corners of the world. Also: two funds run out of Louisville, Ky., each among the past year's top performers.



Illustrations by Randy Enos

Panoramic View

Taking their name from a scenic road in Louisville, Ky., a pair of funds advised by **River Road Asset Management LLC** focus on "discovering value off the beaten path," says R. Andrew Beck, president of River Road, a subadviser to **Aston/River Road Small Cap Value** and **Aston/River Road Dynamic Equity Income** funds.

The two funds were launched in June 2005, and during the past year each has outperformed the vast majority of peers.

Aston/River Road Small Cap Value, up 30.8% in 2006, is in the top 1% of funds in Morningstar Inc.'s "small-value" category, those that primarily buy shares of smaller companies that are deemed inexpensive based on factors such as share price to earnings per share.

Aston/River Road Dynamic Equity Income was up 25.5% in 2006. It buys stocks of various sizes, and Morningstar currently classifies it as a mid-size-value fund, where its 2006 return puts it in the first percentile of that category.

Reflecting investors' huge appetite for small-stock funds as the category has outperformed for much of the past five years, the small-cap offering will stop accepting new money Jan. 10. River Road neared a target size of \$1 billion under man-

agement following the fund's strategy. The mutual fund holds about \$280 million, and River Road has another \$500 million or so in accounts, for pension funds, endowments and other institutional investors.

The **Dynamic Equity Income** mutual fund is much smaller at \$21 million, while institutional accounts following its strategy total \$1.7 billion. The managers aim to close this strategy to new investment when money following it hits a combined \$5 billion.

The funds' stock-picking teams overlap. Working on both are James C. Shircliff, and Henry W. Sanders III, who together have a combined 50 years of money-management experience. Mr. Shircliff's background includes a stint running the fund now known as **Longleaf Partners Small-Cap Fund** in its early years in the late 1980s and early 1990s, for **Southeastern Asset Management Inc.**, of Memphis, Tenn. The Longleaf funds long have been highly regarded in the world of value investing. Mr. Beck rounds out the small-cap fund's team.

The **Dynamic Equity Income** fund looks for stocks with high yields (dividend per share divided by the stock price) as well as an opportunity for capital appreciation, Mr. Beck says. "We target a minimum yield of 3%," and "we look for stocks that are trading at a minimum of 90 cents or less on the \$1," in terms of how the man-

agers see them properly valued.

Also required: an attractive business model and shareholder-oriented management.

As of Oct. 31, the fund had more than two-thirds of its money in the financial sector, and about 14% in energy stocks. Top holdings included **Barclays PLC**, one of the United Kingdom's biggest banks, and **Bank of America Corp.**

The fund's expense ratio is 1.3%, which puts it below the 1.41% average for diversified U.S. stock funds, according to Morningstar. The fund is available through various brokerage-firm fund supermarkets, and investors can find more information on the Aston funds at www.astonasset.com.

The funds had carried the **ABN AMRO Asset Management** name, but were rebranded when the Amsterdam financial-services company completed the sale of its U.S. mutual-fund business to **Highbury Financial Inc.**, of Denver, and the funds became part of its **Aston Asset Management LLC** unit, of Chicago.

Hot Region's Old Twist

While many Asian funds focus on shares of rapidly expanding companies in the up-and-coming region, **Matthews Asia Pacific Equity Income Fund** goes an old-fashioned route: It scouts for dividend-paying shares.

The fund, launched Oct. 31, is the ninth offered by **Matthews Asian Funds**, of San Francisco, which Morningstar calls a "first-rate Asian boutique." The \$11 million fund draws on Matthews' investment staff, with 14 professionals—experienced living or working in Asia—researching potential holdings.

The new offering is philosophically close to **Matthews Asian Growth & Income Fund**. That fund owns many dividend-paying common- and preferred stocks, making it "much tamer than most of its rivals," according to a November Morningstar report. In return for reduced volatility, the fund has tended "to lag during strong rallies," as it did in 2005 and 2006, though it "has gained much more than the majority of its peers over the long run." The \$2 billion fund is closed to new investors.

Neal Frankle, president of **Wealth Resources Group**, of Woodland Hills, Calif., says dividend-paying stocks

"by nature...are going to be companies that are a little more conservative," making the new fund a potentially interesting play for some risk-averse investors.

David Snowball, who reviews funds in the Annex section of **FundAlarm.com**, a free Web site about mutual funds, likes the focus on dividends. The fund is "apt to have moderate risk...and [offers] the services of one of the best regional investment teams," he wrote last month.

Lead manager is Andrew T. Foster, who also works on two other Matthews funds. Morningstar notes that he has been with the firm since 1998, except for a break to earn a graduate business degree.

The fund's biggest holdings as of Nov. 30 included Hong Kong banking company **HSBC Holdings**, contract-chip maker **Taiwan Semiconductor Manufacturing Co.**, and telecommunications company **Chunghwa Telecom** of Taiwan. The three countries with the biggest representations were Japan, at 18.3%, China/Hong Kong, at 17.6%, and Taiwan, at 12.8%.

Jesper Madsen, who co-manages the fund, anticipates Japan may be better represented going forward. "With the dismantlement of cross-shareholdings and strengthening of minority shareholders in Japan, we've started seeing these companies move away from very low fixed-dividend payments to now talking more about payout ratios and giving minority shareholders greater access to earnings," he says.

Mr. Madsen says the investment team also seeks to lower risk by meeting with management of companies whose shares are bought. "We have all the access we can wish for," he says. However, he notes that Asia is volatile, and investors should go in with open eyes.

The new fund carries a 1.47%-of-assets expense ratio, below the average Asia stock-fund ratio of 1.93%.

Safety in Numbers

Wasatch Advisors, a Salt Lake City investment firm founded in 1975, believes "the more people looking at the problem, the more likely to come up with a solution," says Samuel S. Stewart Jr., lead manager of **Wasatch Strategic Income Fund**. That is one reason there are 40 people working on the \$15 million fund,

launched last February.

Wasatch Strategic Income also seeks safety by focusing on income-producing stocks. "Our point of distinction isn't on the [stock] size. It's on the ability to pay a growing dividend," says Mr. Stewart, a former chief financial analyst at a division of the Securities and Exchange Commission.

The fund prefers stocks with a dividend yield of about 4% to 6%. While every stock doesn't have that yield, those with lower yields are expected to increase dividends, he says. The fund can also own bonds.

Mr. Snowball likes that the fund aims to "systematically combine and periodically re-weight three distinct sorts of income-producing investments": blue-chip stocks with relatively strong dividend yields, shares of rapidly expanding companies that don't throw off a lot of income but are positioned to do so, and value stocks that throw off a lot of current income and have the potential for a rebound.

"You wouldn't expect all three of those sorts of investments to be firing at the same time, but you would expect that at least one of them would be hot in a capital-appreciation sense at any given time and all of them would be paying you as you wait," he says.

This approach, he adds, contrasts with many mutual funds that "stock their portfolios with similar stocks," mostly large-cap value shares

with relatively modest dividend yields, "which tend to cluster in two or three predictable areas like financials and utilities."

That said, the fund's heaviest concentration, as of Sept. 30, was in the financial-services sector, at nearly 60%.

Among top holdings: real-estate investment trust **Redwood Trust Inc.**;

credit-card and financial-services firm **Capital One Financial Corp.**, and home-mortgage lender **Countrywide Financial Corp.**

The fund is part of an evolution of Wasatch's longtime focus on small stocks. It aims for a total return somewhere between stocks and bonds.

The fund's expense ratio is a below-average 0.95%. The fund is available through fund supermarkets and www.wasatchfunds.com.

The fund is up 19.1% since its launch compared with 12.6% for the Standard & Poor's 500-stock index, including reinvested dividends, from February 2006 through Dec. 31.

