

WEALTH MANAGER

CAMBIAR OPPORTUNITY BUYS SOLID COMPANIES THAT HAVE DROPPED TO THE CELLAR.

Cheap Blue Chips

By Stan Luxenberg

MANAGERS OF LARGE-CAP FUNDS HAVE GOOD REASON TO FEEL exasperated. For seven straight years, small-blend funds have outdone large-blend, according to Morningstar. Is that losing streak a record? Not yet. Small stocks outdid large ones for 10 years beginning in 1974, according to Ibbotson Associates.

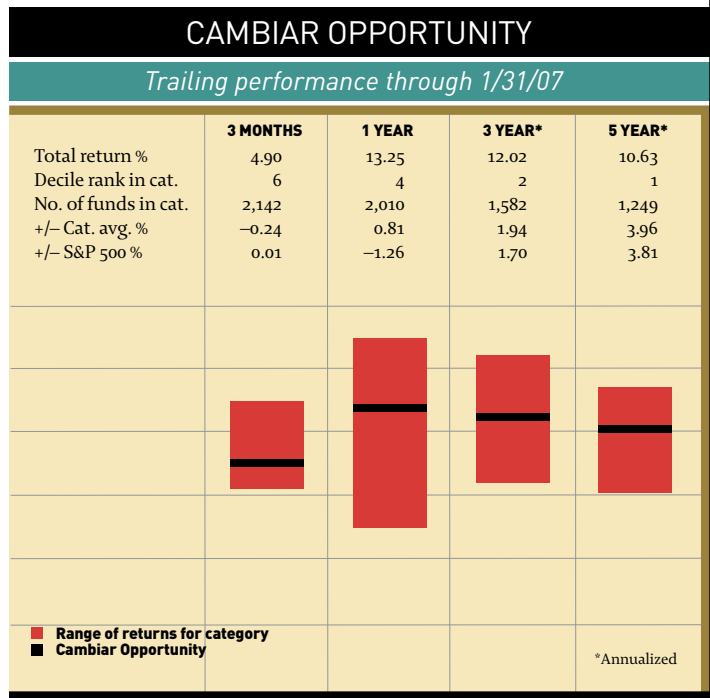
Still, large-cap managers have reason to take heart. By many measures, small-cap funds seem pricey. While large-blend funds have average price-earnings ratios of 15.7, small blend commands a figure of 17.0. Large-blend portfolios boast trailing annual earnings growth of 18.7 percent, while small blend only has a growth rate of 16.6 percent. Eventually the small-cap funds seem bound to slip. Meanwhile, investors should continue holding a sizable large-blend stake. The large-cap funds focus on blue chips of the Standard & Poor's 500-stock index, the kind of solid names that should anchor most portfolios.

To find the best large-blend choice, *Wealth Manager* once again turned to the eight-part screens developed by Donald Trone, chief executive officer of FI360, a consulting firm in Sewickley, Pa. Trone's due-diligence process seeks funds that have more than \$75 million in assets and are at least three years old. One- and three-year total returns must exceed the category medians, as must five-year results if the fund is that old. The expense ratio must fall below the top quartile, and at least 80 percent of the fund's holdings must be consistent with the category. To narrow the choices, we added our own criteria, requiring that managers have tenure of at least five years.

The screens reduced the field from 2,206 down to 68 finalists. Top contenders included MassMutual

Select Focus Value S and Mainstay MAP I, but we eliminated them since they are designed for institutions. Davis New York Venture A is aimed at retail investors, but we awarded the title to Cambiar Opportunity, which had higher five-year returns.

Cambiar achieved its victory by following a tight valuation discipline. Portfolio manager Brian Barish looks for companies that sell for less than their average historical prices as measured



Best of Breed	Ticker	5-Year annlzd return	5-Year standard deviation	5-Year-rtn category % rank	3-Year annlzd return	3-Year-rtn category % rank	12-Mth total return	12-Mth-rtn category % rank	Gross expense ratio	Turnover ratio
Cambiar Opportunity	CAMOX	10.63	13.16	5	12.02	17	13.25	40	1.34	38
Runners-up										
Davis New York Venture A	NYVTX	10.56	11.27	6	12.43	13	14.70	16	0.88	6
Mainstay MAP I	MUBFX	10.85	12.63	5	13.25	8	13.48	36	0.97	100
Benchmarks										
S&P 500	—	6.82	12.37	—	10.32	—	14.51	—	—	—
Morningstar Large Blend	—	6.65	12.34	—	10.06	—	12.43	—	—	—

SOURCE: Morningstar Principia. Data as of 1/31/07

by price-earnings ratios or other indicators, such as price-sales figures. Such depressed companies may be cheap because of real problems—or simply the whims of the market, Barish says. Either way, once a stock lands in the cellar, it can stay there for years. To avoid being saddled with long-term losers, Barish seeks companies that seem poised to revive. Such companies may be about to introduce a new product or sell a losing division. “We look for situations where the business profile will look very different one or two years from now,” he says.

As an additional precaution, he avoids businesses that are losing money. Instead, he prefers profitable companies with strong balance sheets. Barish tends to emphasize industries—such as health and consumer products—that can generate high rates of return on capital over long periods. He avoids cyclical businesses, such as commodities, which have erratic rates of return. Many holdings have long track records and strong franchises. “We are not deep-value investors who buy troubled companies like Ford or General Motors,” he says.

One of the fund’s biggest winners in 2006 was DirectTV Group, a stock that gained mainly because of changes in the market’s mood. The shares stagnated in 2004 and 2005 as investors worried that cable companies would steal customers from satellite providers like DirectTV. Cable giants were promoting their ability to deliver a package of services—including voice, video, and data—to homes. Meanwhile, DirectTV fought back by offering a wide selection of TV channels and high-definition programming. Barish was convinced that the satellite company would not vanish, and he bought the stock at a time when the price-earnings ratio was 10, about half the figure of competing cable companies. Gradually,

other investors came to share Cambiar’s view, and the stock rose from less than 14 to more than 24.

A big holding in the fund is chip giant Intel, which sells for 2.5 times sales—near the bottom of the stock’s long-term trading range. The shares have sunk since the company began losing market share to its chief competitor, Advanced Micro Devices. In 2006, the earnings and profit margins disappointed investors. But Barish believes that the company will revive soon, bringing out new products for personal computers and getting rid of unprofitable communications businesses. “Now that Intel is refocusing on its strengths, the company will be very profitable over the next three years,” says Barish.

Barish is keen on Sanofi-Aventis, a French pharmaceutical giant. Investors are shunning the stock because the company will lose patent protection for some of its drugs in the next few years, but Barish says that the company has growing businesses in vaccines and antibiotics. In addition, there are a number of drugs in the product pipeline—including a diet drug—that have the potential to achieve sizable sales. “The company’s price is about as cheap as drug companies ever get,” says Barish. “Even a little bit of good news would push up the shares quite a bit.”

After buying such unloved stocks, Barish holds on for several years. Once shares reach their fair values, he sells. Since many of his picks succeed, this value-oriented fund tends to stay in the blend box—while delivering steady returns for patient shareholders.

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CAMBIAR OPPORTUNITY TOP 25 HOLDINGS

Rank	Security name	Percent net assets
1	Intel	4.12
2	Infineon Technologies	3.86
3	The Western Union Company	3.68
4	Washington Mutual	3.03
5	Altria Group	3.02
6	CVS	3.02
7	Wyeth	2.99
8	Home Depot	2.99
9	GlobalSantaFe	2.99
10	Amgen	2.94
11	Target	2.68
12	Halliburton	2.67
13	WPP Group PLC ADR	2.65
14	El Paso	2.63
15	Sanofi-Aventis ADR	2.62
16	MBIA	2.57
17	ACE	2.37
18	Microsoft	2.28
19	Diebold	2.19
20	Baker Hughes	2.19
21	Chevron	2.16
22	Bank of America	2.03
23	St. Paul Travelers Companies	2.00
24	Cigna	1.98
25	AT&T	1.96

SOURCE: Morningstar Principia. As of 12/31/06. (Not audited; for informational purposes)

SOURCE: Morningstar Principia. Data as of 1/31/07

Best of Breed	Best-fit index	Best-fit R sqrd	Best-fit alpha	Best-fit beta	3-yr Sharpe ratio	12-mth yield	Net assets (\$MM)	% Assets in top 10 holdings	Annual return 2006	Annual return 2005	Annual return 2004	Annual return 2003
Cambiar Opportunity	Russell 1000	86	0.93	1.01	1.08	0.44	1,482.60	32.64	16.64	7.01	15.05	35.23
Runners-up												
Davis New York Venture A	S&P 500	83	3.03	0.83	1.39	0.69	27,899.70	38.10	15.12	10.68	12.37	32.34
Mainstay MAP I	Russell 1000	89	1.29	1.11	1.14	0.46	371.60	28.60	16.44	8.93	16.29	38.72
Benchmarks												
S&P 500	—	—	—	—	—	—	—	—	15.79	4.91	10.88	28.69
Morningstar Large Blend	—	—	—	—	—	—	—	—	14.17	6.03	10.43	27.94

