



## Focused Funds Win by Gambling on a Handful of Stocks

By Rob Wherry  
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**CHASE GROWTH FUND** (CHASX<sup>1</sup>) recently celebrated its 10th birthday and, by all accounts, it had plenty to commemorate. Even though the fund doesn't get a lot of attention — it's located far from Wall Street in Charlottesville, Va. — its performance rivals that of its much flashier competitors. Since its inception, Chase Growth has returned an average annual 9%, clobbering both the S&P 500 and the Russell 1000 Growth indexes by three and six percentage points, respectively.

In any given week, that performance is good enough to grab our attention. But we are also turning the spotlight on this fund for an additional reason: Chase Growth is what's called a focused fund. This category of offerings features portfolios with just a few dozen investments, about one-third the amount of a typical domestic equity fund. Instead of sprinkling a percentage point or two of assets among a wide variety of names, focused funds can have 10% or more of its money in just one stock. There's a risk involved with a strategy like that, especially in an environment where the stock market is increasing and decreasing 200 or 300 points in a single session. However, if the bets pay off, the returns can be significant.

"I'm pretty favorable to using focused funds in this environment," says Jim Suits, a principal at Summit Capital Advisors in Tacoma, Wash. "The market drops are sudden and short-lived so I think they create buying opportunities [for the managers of these funds]."

In order to construct this week's screen, we had the folks at Lipper sift through the equity fund universe in search of portfolios with 50 or so stocks. This week, though, we altered some of our usual criteria. Since focused funds can be volatile, we tightened our performance criteria so that only funds with track records in the top 25% of their peer group made our cut. In addition, we also wanted funds whose managers had been in place for longer than five years. We think experience is crucial when it comes to running a focused fund. So we shied away from the ones with newcomers running the show. What remains is a list of 11 funds.

These funds are an excellent complement to index funds, says Suits. If your portfolio is heavy on static S&P 500-type products, you might want to consider adding one of these offerings as a way to get some extra returns on the margins. He suggests building a small position, maybe 5% to 10% of a person's entire portfolio.

It's easy to see why Suits doesn't suggest a larger position. **Oakmark Select** (OAKLX<sup>2</sup>), run by well-regarded value manager Bill Nygren, is a perfect example of how a focused fund can easily

fall off course. This year, the fund's returns are down a miserable 11%, thanks in part, to 13% of the fund's assets being invested in **Washington Mutual** (WM<sup>3</sup>), a stock that has been hammered by the subprime and credit crises. Meanwhile, **CGM Focus** (CGMFX<sup>4</sup>), the best performer on our list, has a whopping 333% turnover, according to Morningstar. That rapid trading has paid off, but it's still a bit high for our taste. So either scenario makes for an investment that could give you some headaches.

Over at Chase Growth, the three managers, including company founder Derwood Chase, start with a list of around 600 companies that typically have market capitalizations over \$1 billion. They narrow that universe down by looking for companies with long-term, consistent increases in earnings per share. They also study insider buying, cash flows and whether a given industry is coming back into favor. Around 40 to 60 of their best ideas are then assigned price targets. Recently, the fund has been buoyed by tech stocks, including top holding **EMC** (EMC<sup>5</sup>), **Oracle** (ORCL<sup>6</sup>), **Cisco Systems** (CSCO<sup>7</sup>) and **Hewlett-Packard** (HPQ<sup>8</sup>). Although, energy stocks and consumer names like **McDonald's** (MCD<sup>9</sup>) and **Coca-Cola** (KO<sup>10</sup>) have also helped performance. The fund has returned 21% so far in 2007. It's also in the top 3% of its Lipper category over the last decade.

One focused fund that is a perennial finalist on our list is **Fairholme** (FAIRX<sup>11</sup>). Managers Bruce Berkowitz, Larry Pitkowsky and Keith Trauner are fans of Warren Buffett's value investing strategy. Indeed, the fund's largest holding, at almost 19% of the portfolio, is **Berkshire Hathaway**, both the A (BRK.A<sup>12</sup>) and B (BRK.B<sup>13</sup>) shares. The trio is also making a 17% bet on **Canadian Natural Resources** (CNQ<sup>14</sup>), an oil sands and natural gas firm. And a 20% cash position has given the managers some flexibility during the recent market turmoil. (They've been buying on the dips.) "We like the environment of the last few months," says Pitkowsky. "It's like going into the grocery store and finding all the food you need to buy is marked down." The fund's 19% average annual return over the last five years puts it near the top of Morningstar's large blend category.

## The Criteria

The funds on our list this week have 50 or fewer stocks in their portfolios. The no-load equity funds are open to new money, require a minimum investment under \$5,000 and charge an annual expense ratio less than 1.5%. The funds' performance track records over the trailing three- and five-year time periods put them in the top 25% of their respective peer groups. We also looked for managers who had been in place over five years.

## Focused on Returns

Company	No. of Stocks in Portfolio	Expense Ratio (%)	3-Year Average Annual Return (%)	5-Year Average Annual Return (%)
CGM Focus (CGMFX <sup>15</sup> )	26	1.02	37.2	35.4
Chase Growth (CHASX <sup>16</sup> )	35	1.17	11.0	13.4
Fairholme (FAIRX <sup>17</sup> )	31	1.00	15.8	18.8
FBR Focus (FBRVX <sup>18</sup> )	41	1.38	11.9	20.4
FMI Large Cap (FMIHX <sup>19</sup> )	22	1.00	11.1	16.0
Janus Orion (JORNX <sup>20</sup> )	48	0.99	24.5	25.3
Marsico Focus (MFOCX <sup>21</sup> )	30	1.22	11.5	14.6
Permanent Portfolio Aggressive Growth (PAGR <sup>22</sup> )	39	1.26	13.1	16.7
Stratton Multi-Cap (STRGX <sup>23</sup> )	41	1.05	11.8	19.1
TCW Focused Equities (TGFVX <sup>24</sup> )	35	1.38	11.1	15.4
Westport (WPRX <sup>25</sup> )	36	1.49	14.3	17.1

Source: Lipper

Note: Data as of Dec. 14, 2007