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MUTUAL FUNDS REPORT

Three Who Steered Away From the Cliff

By TIM GRAY

WHEN the stock market tanks, mutual fund managers prove their mettle. After all, neither investing in Amazon during the tech bubble nor in Exxon Mobil during the oil boom required great resourcefulness or a well-tuned strategy. But it was helpful to have both qualities in the meat-grinder market of 2008 — not to mention a dollop of luck.

The managers of three of the better-performing funds in the fourth quarter found refuge in far-flung places and divergent strategies.

One invests only in Japan. Another aims to achieve gains by betting partly on the likelihood that mergers will close. And the third uses computers and statistics to profit from short-term mispricings in stocks. Whatever their strategy, their shareholders benefited in the quarter, receiving some respite from crashing markets around the world.

No Gain, but Limited Loss

The Nikkei 225, the Japanese stock index, fell 42 percent in 2008 — even steeper than the 38.5 percent plunge by the Standard & Poor's 500. It was the worst performance in the 58-year history of the Japanese benchmark. And while Taizo Ishida, manager of **Matthews Japan**, did not make money for investors, he limited his fund's losses to 9.7 percent for the quarter and 28 percent for the year.

Many managers stick to the weightings of the indexes that serve as their performance benchmarks. Thus, a Japan fund might keep 10 percent of its money in energy stocks because they also represent that much of the Nikkei.

But Mr. Ishida, who is based in San Francisco, regularly strays from his index — in his case, MSCI Japan — and thus lately shied away from sectors like utilities. Unlike some managers of Japan-only funds, he also loads up on small- and mid-capitalization stocks.

"I'm sector-agnostic," he said. "If I like the company, I put it in the portfolio. And



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The Matthews Japan fund, led by Taizo Ishida, likes to venture beyond the index that serves as its performance benchmark.

my fund is biased toward big themes."

Among his themes is the aging of Japan — about one in five Japanese are 65 or older, according to the country's national statistics bureau. Mr. Ishida said he reasoned that older people long for companionship and thus acquire pets, so he accumulated a big stake in **Unicharm Petcare**, which makes pet supplies.

Similarly, as people age in Japan and elsewhere, Mr. Ishida expects them to turn to more health care. So he gravitated to medical device companies like **Sysmex** and **Terumo**. But he shunned Japanese drug makers because he rates them as costly compared with their counterparts

in the United States.

"Why pay 15 times earnings for a big Japanese pharma," Mr. Ishida asks, "when you can buy Johnson & Johnson at 10 times earnings?"

The fund, which carries a 1.23 percent expense ratio, has had an uneven record. It has performed well lately — Mr. Ishida took over two years ago — but it has been erratic over longer periods. Over the five years that ended Dec. 31, it lost 3.5 percent, annualized, putting it among the worst-performing international funds for that stretch. But over 10 years, it fared better, with an annualized return of 2.4 percent, 1.1 percentage points better than its peers.

Assessing the Deals

Like Mr. Ishida, Mario J. Gabelli, of the **Gabelli ABC** fund, does not emphasize whether a stock appears in an index or represents a particular sector when he makes picks for the portfolio.

Mr. Gabelli earned his reputation as a value investor — someone who tries to find stocks trading for less than his estimate of their intrinsic worth. Value managers typically seek out-of-favor offerings and hold them for a long time. But with **Gabelli ABC**, Mr. Gabelli wants a lot of small, quick gains that can add up to a stable return.

“This fund is designed to always be up,” he said. “And we’re willing to give up upside to do that. It’s not going to be 20 percent in a year. We didn’t quite make our goal this year, but I’m not complaining about losing a toe when other people lost their feet.”

The fund was down 1.2 percent for the quarter and 2.6 percent for the year.

One of Mr. Gabelli’s tactics is scooping up acquisition targets. Once a deal is announced, he assesses whether it will close. If he thinks that it will, he buys. That led him to **Anheuser-Busch** after InBev of Belgium made a bid of \$65 a share. Uncertainty about the deal’s prospects stemmed from resistance in Missouri, Anheuser-Busch’s home state. InBev sweetened its offer, and **Gabelli ABC** pocketed a profit.

Not every deal closes, of course, and the fund can suffer as a result. Mr. Gabelli accumulated shares of **Yahoo** after Microsoft offered about \$45 billion for it. In his view, Yahoo made a mistake in saying no: “Microsoft knocks on the door with an all-cash bid. All they had to do is say, ‘Give us another buck.’” Instead, Yahoo spurned its suitor, and its shares have sunk with the market since.

Gabelli ABC zips in and out of many stocks. The fund’s annual turnover ratio is about 200 percent, meaning it holds a stock, on average, for about six months. The typical fund turns about 80 percent of its portfolio a year.

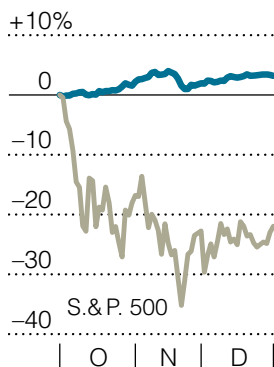
Frenzied Trading

Mr. Gabelli’s trading looks quiet next to the frenzied style of **JPMorgan Highbridge Statistical Market Neutral**. With a turnover ratio of nearly 400 percent, it effectively flips its entire portfolio four times a year.

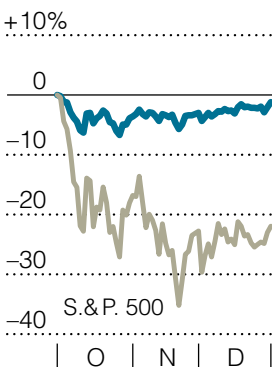
Faring Better in a Bad Market

Three funds that outperformed the overall market — and their peer groups of stock funds — in the fourth quarter.

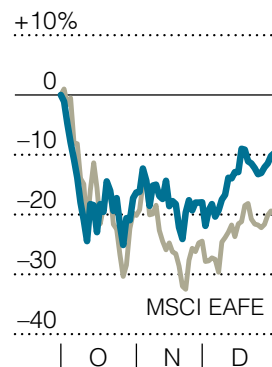
Highbridge Statistical Market Neutral Select



Gabelli ABC



Matthews Japan



FOURTH-QUARTER RETURNS

Highbridge Statistical Market Neutral Select

+3.2%

Specialized

-22.5%

Gabelli ABC

-1.2%

General stock

-22.1%

Matthews Japan

-9.7%

International stock

-21.1%

Sources: Morningstar, Bloomberg

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Whippet-fast reactions are part of its quantitative strategy. Statistical arbitrageurs like Evan L. Dick, the senior portfolio manager, use computers to spot short-term pricing anomalies and try to exploit them quickly. Sometimes, they are in and out of a stock within a day. In effect, they skitter around trying to grab nickels and dimes, while other investors pray for dollars.

The fund both buys shares in companies and sells them short, which is a way of making money on stock drops.

In 2008, Highbridge managed to deliver positive returns even as the rest of the market dropped. It had a total return of 3.2 percent for the quarter and 10 percent for the

year. It had an expense ratio of 1.95 percent.

Managers of quantitative funds typically do not reveal much about their investing formulas, and the Highbridge group is little different in this respect. Mr. Dick and Alain M. Sunier, the portfolio manager, would not say much about exactly where they found values in the fourth quarter, though they were happy to talk about the advantage of computers over humans in buying and shorting stocks.

“A human could’ve had a fight with his wife,” Mr. Dick said. “Humans forget things.”

Computers are hardly infallible, but he said he trusts his machines enough that his mother invests in the fund.