

THE WALL STREET JOURNAL.

TUESDAY, MAY 12, 2009

© 2009, Dow Jones & Company, Inc. All Rights Reserved

Contrarian Patience Pays Off -- Finally

Beaten-Down Fund Managers Are Back Up

BY SAM MAMUDI

Warren Buffett famously said he tries to be fearful when others are greedy and greedy when others are fearful. For some money managers, that isn't just clever advice -- it is an entire investing strategy.

The idea of embracing out-of-favor stocks, sometimes called contrarian investing, isn't new. But the approach requires a strong stomach in the best markets, let alone during historic downturns.

And as investors rushed for the exits last year, these managers kept diving in, frequently engaging the most feared areas of the market.

"It's not uncommon for a new client to call me when I buy a stock, asking me what the hell I'm thinking," said Bernie McGinn, president and chief investment officer of McGinn Investment Management Inc.

But clients soon get used to his unorthodox approach, Mr. McGinn said, often asking why he isn't making certain buys. "The basic premise of investing is 'buy low and sell high,'" he said. "And low is when nobody else wants it."

Even the professionals don't always get it right. Legendary contrarian-minded managers such as David Dreman and Marty Whitman had a tough 2008, with Dreman Contrarian Large Cap Value Fund (symbol: DRLVX) and Mr. Whitman's Third Avenue Value Fund (TAVFX) losing 45% and 46%, respectively. And Bill Miller of Legg Mason Inc., another manager with a contrarian bent, saw his Legg Mason Value Trust (LMVTX) fall 55% in 2008.

As the market has rebounded in recent weeks, these and other contrarian-style funds, with their bargain-minded ways, have been outperforming. Dreman Contrarian Large Cap Value is up about 7% so far this year, while Third Avenue Value has gained around 13%

and Mr. Miller's fund is up 8% -- well ahead of the Standard & Poor's 500's 0.7% rise.

Contrarian investing is "a discipline that's hard for an individual investor to follow," said Russ Kinnel, director of mutual-fund research at investment researcher Morningstar Inc. "It's tough to know when to get in and when, in fact, a stock deserves to be battered."

The managers at Evergreen Capital Management take Mr. Buffett's advice almost literally. The firm studies the flow of money moving into and out of mutual funds as a starting point for its investment decisions, looking into areas of the markets where net outflows -- selling pressure -- is greatest.

"Most investors are 'wrong-cycle investors,'" said David Hay, chief investment officer. They chase performance, focus on short-term results, show impatience and ignore market cycles.

But patience is the key. Mr. McGinn said his portfolio turnover rate is about 30% -- about one-third of its holdings are changed each year. The industry average for a U.S. stock fund is 100%, according to Morningstar.

"If you had a one- or two-year view, I don't see how you'd buy anything right now because earnings outlooks are so low," added Ian Lapey, senior member of the investment team at Third Avenue Value.

Mr. Lapey said his fund holds a stock for about five years on average, and historically has had a turnover rate of 10%, though partly because of redemption requests last year that figure has climbed to about 20%.

Investors should have at least one contrarian-style fund in their portfolio, Morningstar's Mr. Kinnel said. "It can lead you to profitable investments," he added. His favorites include Third Avenue Value and FPA Capital Fund (FPPTX), which is up 18% this year

after falling 35% in 2008.

FPA Capital's manager Bob Rodriguez, however, plans a "one-year sabbatical" from the fund beginning in January. Mr. Kinnel also suggested FPA Crescent Fund (FPACX) as a similar fund but one whose manager, Steven Romick, has no plans to leave. FPA Crescent lost 21% in 2008 and is up 7% so far this year.

Some of the stocks picked by the managers live up to a contrarian billing: Bank of America, New York Times and Ford Motor.

Mr. McGinn said he likes Bank of America in part because the shares are being valued "in crisis mode" and not according to true worth. "They have the biggest wealth manager and the biggest originator of mortgages," he said. He added that once he had decided the bank wouldn't be nationalized, its price looked cheap.

Keep in mind, however, that contrarian investing is no guarantee of success -- as last year's results for some funds prove.

"Each manager is different, but these guys can get it wrong, too," Mr. Kinnel said. Not just wrong, but spectacularly wrong. "They buy stocks thinking things can't get worse," said the Morningstar analyst, "but last year was such a bad year that areas such as financials, and other cyclical names, kept getting worse."