

# BUY HIGH, SELL LOW?

**O**NCE AGAIN comes news (this time from Pace University's Matthew Morey) that the major fund-rating systems cannot predict future success. They're a poor way to choose a fund.

Before blaming Morningstar and others who rate stocks, consider this: Ratings are a sideshow to the bigger issue of performance chasing, which has gone on since the dawn of funds. Yet investors stubbornly refuse to alter their follow-the-leader pattern of moving money to the fund doing best lately, despite widespread awareness that this approach fails.

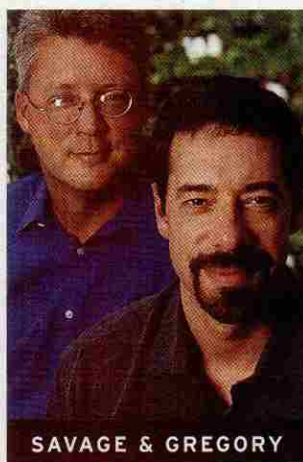
**What's wrong here?** Let's even assume that the big numbers a fund racks up result from the manager's skill. Still, the ensuing new money creates a host of subtle difficulties that can affect a manager's investment edge: It's harder to buy and sell. A team becomes diluted as new analysts are added. Marketing and administrative duties pile up. Success also breeds hubris, which leads to downplaying problems and taking shortcuts. More likely the good results are a matter of luck—a fund invests in large, fast-growing companies and their turn in the investment cycle comes around. The money tide rolls in just as the cycle shifts, then leaves after the downturn, locking in the losses.

Okay, what should you do? Two suggestions: First, decide what types of funds to own and in what proportions. Diversification reduces your risk sharply. Second, when picking funds, don't guess. If you don't have a good reason to choose an active manager, use index funds. The edge in expenses is a certainty, and human error won't spoil things.

If you want an active manager, ask why this person might do better than the herd—that it happened once is no reason it will happen again. So what characteristics should you look for? Which traits of success are predictive?

We think there are several. Excellent fund managers are

*Steve Savage (left in photo) is editor and publisher and Ken Gregory president of No-Load Fund Analyst newsletter (www.litmangregory.com). Their firm is also adviser to the Masters' Select funds.*



**Performance chasing has gone on since the dawn of funds. Alas, investors just won't learn.**

passionate, independent thinkers. Their well-defined approach gives them an identifiable edge—either in the information they collect or in the way they interpret and analyze it, or both. They are competitive, disciplined and experienced, which gives them courage to stand behind their convictions even if they are unpopular. They are shareholder-focused and will close a fund before assets become too heavy. Their focus and love of what they do lead them to avoid distractions. It shouldn't be hard to find information on managers—interviews, profiles, shareholder letters—that will give you a feel for where they stand with respect to these criteria.

**Case in point.** Mason Hawkins and the **Longleaf Partners** fund team (symbol LLPFX; 800-445-9469) are extremely disciplined and patient. In the late 1990s, after

a multiyear run of mediocre returns, many investors lost confidence. But nothing had changed; the managers understood why they owned every stock and had utter confidence that they'd be rewarded eventually. They were.

Today, growth manager Glen Bickerstaff of **TCW Galileo Select Equities** (TGCEX; 800-386-3829) faces similar scrutiny. Glen is a great manager because his understanding of his companies and why they will reward him over the long haul remains unshaken. In our portfolios, we aren't about to eliminate funds like his. Despite his fund's losses since early 2000, it has done better than the Russell 1000 Growth index, with which we compare him, and his approach and discipline remain rock solid.

Great managers are great in part because they possess confidence in their decisions and the discipline to ignore short-term disappointment, recognizing it as an inevitable part of investing. In the long term, they are rewarded. That's a lesson for all of us. **K**

