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Q&A

Value Fund Buys Stocks On Sale After Bad News

The Polaris Global Value Fund is betting big on U.K. homebuilders and likes JP Morgan and Samsung.

By CRYSTAL KIM

Between 1978 and 1980, when U.S. equity markets were taking a beating, Bernard Horn had a revelation. "If the U.S. market was doing terribly, maybe there were other places in the world benefitting from that misery," says Horn, then a student at MIT's Sloan School of Management.

It turns out he was right. Amid oil-price shocks, oil-producing nations thrived as the U.S. suffered a long period of stagflation.

Horn, 61 and the lead manager of the $355 million Polaris Global Value Fund (ticker: PGVFX), now applies a similar value-investing strategy to markets here and abroad to take advantage of pricing inefficiencies. He looks for opportunities to buy good stocks on the cheap when a negative event occurs.

"Markets are generally pretty efficient, but there are times when investors react predictably to certain stimuli," explains Horn. "The flight response to fear encoded in our DNA plays out day in and day out in security markets worldwide."

Horn's job is to lean into that fear. As a result, his fund has produced formidable returns over both the long and short term. In the past 15 years, the fund has returned 9.7% annually net of its 0.99% fee, beating the MSCI World Index's 5.8% return and 97% of its world-stock fund peers. Over the past 12 months, the fund has returned 1.8%, while the MSCI World Index sank 0.44%.

Right now, Horn likes United Kingdom homebuilders Barratt Development (BDEV.UK), Taylor Wimpey (TW.UK), Persimmon (PSN.UK), and Bellway (BWY.UK); Thailand's Siam Commercial Bank (SCB.Thailand); U.S. financial-services

companies JPMorgan Chase (JPM) and Franklin Resources (BEN); Samsung Electronics (005930.Korea); and Finnish elevator manufacturer Kone (KNEBV. Finland).

Barrons.com spoke with Horn to get his take on these and other potential bargains.

Barrons.com: How do you whittle down a universe of global stocks to just 85?

Horn: We have a database of about 40,000 publicly traded companies in the world, which is pretty much everything. As a side note, if you go back to the year 2000, the number was closer to 15,000. So we take 40,000 companies and run them through screens to whittle it down to 2,000. These are companies that look as though they are priced to help us beat our benchmark, the MSCI World Index.

We investigate those further, and find that many of those companies are priced at that level for good reasons. So those companies are unlikely to generate excess return because of some flaw in the company, in the industry

MANAGER'S BIO

POLARIS GLOBAL VALUE FUND
NAME: BERNARD HORN
AGE: 61
TITLE: FOUNDER, PRESIDENT, AND PORTFOLIO MANAGER
EDUCATION: B.S. IN BUSINESS ADMINISTRATION, NORTHEASTERN UNIVERSITY; M.S. IN MANAGEMENT, ALFRED P. SLOAN SCHOOL OF MANAGEMENT AT THE MASSACHUSETTS INSTITUTE OF TECHNOLOGY
HOBBIES: SAILING, HAM RADIO, HANDBALL

that it operates in, the management team, and/or the assets that they have. My job is to find out which companies are truly underpriced and which ones the market is being too pessimistic about.

Which metrics do you focus on?

When we are screening we look at historical cash flows. We have a unique definition of it that we call "maintenance cash flow." It is cash a company is generating in operating cash flow after deducting what we call "maintenance capital spending," or an average of what the company needs to spend to keep its business in its current form. When we look at it in terms of the future, we ask, "What does the company need to spend to keep its operating cash flow constant in real terms?" The growth of real cash flow is ultimately the only thing that makes the value of a business rise and is the only reason people should invest in equities.

So where in the world have you been finding value lately?

There has been a lot of value in Europe and Asia. European companies tend to be very well-managed and practice

(over please)

Fund Facts
(as of Sept. 30, 2016)

Polaris Global Value Fund	(PGVFX)
Assets:	$355 million
Expense Ratio:	0.99%
Front Load:	None
Annual Portfolio Turnover:	5%
Yield:	1.21%

Source: Morningstar

Top 10 Holdings
(as of Sept. 30, 2016)

Greencore Group	(GNC.UK)
Samsung Electronics	(5930.Korea)
Ameris Bancorp	(ABCB)
Wesco International	(WCC)
UnitedHealth Group	(UNH)
Lanxess	(LXS.Germany)
Solvay	(SOLB.Belgium)
Siam Commercial Bank	(SCB.Thailand)
Persimmon	(PSN.UK)
Symrise	(SY1.Germany)

Source: Polaris Capital Management, LLC

good corporate discipline. We have a collection of companies there and we continue to find good names there. Scandinavian firms are more globally competitive than most companies in other regions. Countries like Finland and Norway with populations of just 5 million people have companies that are world-dominant in various sectors and have superior ability to adapt to other cultures and incorporate them and work locally in those cultures.

What's an example of one?

Finnish elevator company Kone competes with much bigger rival companies, including Otis, Schindler, Mitsubishi, and Hitachi (6501.Japan). They've been particularly more innovative in what's considered low-tech. About 40% of their sales now come from China and they have a local subsidiary there that they acquired, which helped them better adapt to that market. They've been doing that throughout their history. In order to become global, companies need the majority of their sales to come from outside of their home markets—and that's difficult to achieve for most.

Why is that?

Most U.S. and European companies have big domestic markets, and their businesses tend to be dominated by the local economy they are domiciled in. Whereas in the case of a Scandinavian company, if you only have a local market with 5 million people in a world of few billion, it's a drop in the bucket. We like those types of countries with that attitude, including Taiwan, Korea, and even Japan, which has a comparatively bigger domestic market.

Speaking of Korea, Samsung Electronics is your second-biggest holding. Are you still positive on the stock, given its recent Note 7 smartphone issues?

Samsung is one of the best values we have in the portfolio. It throws off a lot of cash. They have a terrific vertically integrated position in most of the products that they sell, including smartphones. They are dominant in innovation for various components, including screen technology and, to a lesser degree, battery technology.

The problem that we have in smartphones, generally speaking, is that everyone is trying to seal up the battery. That's a big mistake. My Samsung phone opens up so I can replace the battery during the day when it runs out. For whatever reason, the engineers and the marketing people have decided that sealing the battery is an advantage, but in order to make the batteries last a day, they have to push charging systems to the limit. That's what created the problem.

Did you think it was the right move to pull the phones altogether?

Taking it off the market and avoiding all the potential regulatory damage is probably the smartest thing Samsung could have done. The technology obsolescence of cellphones and tech products generally means that what you are selling today isn't what you are going to be selling within six to 12 months from now anyway. In all likelihood, Samsung will come up with a new model to replace the Note 7.

The U.K., at 10%, is, tied with Germany, your second-highest country allocation behind the U.S., at 40%. Why?

We have more concentrated exposure to England because we have four British homebuilders, Barratt Developments,Taylor Wimpey, Persimmon, and Bellway. Most of them were down about the same amount post-Brexit. There was a knee-jerk reaction after the Brexit vote: Nobody would ever buy homes in Britain again! There would be such a dramatic pullback in immigration and housing demand, or not be enough immigrants to help build the houses.

What do you think?

Based on what we knew about the housing market, it was steady business and dominated by local demand. The London market—you have a lot of external demand for high-end property there. But for the most part the U.K. housing market is dominated by the local population, and we didn't expect a dramatic change like in 2008 and 2009 when the credit market seized up.

What are some other countries or sectors you favor?

Almost every country has banks that look very, very attractive. In the case of Thailand, there are things going on in the economy that are overall positives, which should be supportive of the banking sector growth. The economy in Thailand has been tough. They've experienced floods. The king has died, there has been a military takeover, and that's created a lot of very attractively priced stocks. Banks are one of them.

Which do you like in particular?

Siam Commercial Bank is the most conservatively run. They cut back on lending growth several years ago. They've had one-off loan problems that are not systemic to their credit culture. The stock is trading at a very low multiple of eight to 10 times earnings, similar to what they're trading on in terms of cash-flow multiples. The credit culture is good and the capital position is reasonably strong.

What are the best stocks in the U.S.?

We bought JPMorgan Chase in the first six weeks of this year, when the overall world benchmark was down 10%, which is a pretty huge move in the grand scheme of things. Early February, the market was just really free-falling. The broad benchmark was down 10%, but financials were down 25%, and all the big banks were down dramatically. We had been watching JPMorgan for about a year and a half. Shares are around $69 now.

You also added Franklin Resources, the mutual fund company, recently. What did you like about it?

There are more negatives in that. The company has had a good long term track record, but like many long-term investment managers, it often falls out of favor for a period of time, and that period of time could be three to five years or even longer. The strengths in Franklin Resources include its emerging market team headed by Mark Mobius and its fixed-income strategies.

Emerging markets, of course, have been substantially underperforming the rest of the world for seven or eight years. That will turn around, and when it does, that piece of Franklin will recover. Meanwhile, they have a huge cash position of about $7 billion. The only issue there is that most of that is outside the U.S., which would be subject to high taxes if they were to bring it back.

	2016				Annualized as of September 30, 2016						
	YTD	QIII	QII	QI	1 Yr	3 Yrs	5 Yrs	10 Yrs	15 Yrs	20 Yrs	ITD*
Polaris Global Value Fund	**6.33%**	**9.17%**	**-3.29%**	**0.71%**	**11.63%**	**7.89%**	**14.71%**	**4.85%**	**10.31%**	**8.99%**	**9.39%**
MSCI World Index, net dividends reinvested	5.55%	4.87%	1.01%	-0.35%	11.36%	5.85%	11.63%	4.47%	6.29%	5.86%	6.17%

* Inception-to-date (Inception date 07/31/1989)

Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. Returns for more than one year are annualized. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. For the most recent month end performance, please call (888) 263-5594. ***As stated in the current prospectus, the Fund's total annual operating expense ratio is 1.27%. The Fund's annual operating expense ratio has been reduced to 0.99%, effective as of January 1, 2014 through April 30, 2017, due to the Adviser's contractual agreement to waive its fee and/or reimburse expenses to limit Total Annual Fund Operating Expenses. Shares redeemed or exchanged within 180 days of purchase will be charged a 1.00% fee. Fund performance returns shown do not reflect this fee; if reflected, the returns would have been lower. Short-term performance is not a good indication of the Fund's future performance, and an investment should not be made based solely on returns.***

As of September 30, 2016, the Fund's largest equity holdings and the percentages they represent in the Fund's portfolio market value were as follows and are subject to change:

Issuer	Percentage of Total Net Assets	Issuer	Percentage of Total Net Assets
Greencore Group PLC	2.46%	LANXESS AG	1.60%
Samsung Electronics Co., Ltd.	1.83%	Solvay SA, Class A	1.55%
Ameris Bancorp	1.75%	Siam Commercial Bank PCL, Series F	1.55%
WESCO International, Inc.	1.74%	Persimmon PLC	1.54%
UnitedHealth Group, Inc.	1.60%	Symrise AG	1.54%

Before investing, you should carefully consider the Fund's investment objectives, risks, charges and expenses. This and other information is in the prospectus, a copy of which may be obtained by calling (888) 263-5594 or visiting the Fund's website at www.polarisfunds.com. Please read the prospectus carefully before you invest.

The Fund invests in securities of foreign issuers, including issuers located in countries with emerging capital markets. Investments in such securities entail certain risks not associated with investments in domestic securities, such as volatility of currency exchange rates, and in some cases, political and economic instability and relatively illiquid markets. Options trading involve risk and are not suitable for all investors.

On June 1, 1998, a limited partnership managed by the adviser reorganized into the Fund. The predecessor limited partnership maintained an investment objective and investment policies that were, in all material respects, equivalent to those of the Fund. The Fund's performance for the periods before June 1, 1998 is that of the limited partnership and includes the expenses of the limited partnership. If the limited partnership's performance had been readjusted to reflect the second year expenses of the Fund, the Fund's performance for all the periods would have been lower. The limited partnership was not registered under the Investment Company Act of 1940 and was not subject to certain investment limitations, diversification requirements, and other restrictions imposed by the 1940 Act and the Internal Revenue Code, which, if applicable, may have adversely affected its performance.

The MSCI World Index, net dividends reinvested measures the performance of a diverse range of global stock markets in the United States, Canada, Europe, Australia, New Zealand and the Far East. The MSCI World Index is unmanaged and does include the reinvestment of dividends, net of withholding taxes. One cannot invest directly in an index.

Foreside Fund Services, LLC, is the Fund's Distributor.

The disclosure page must accompany the November 8, 2016 Barron's article entitled "Value Fund Buys Stocks On Sale After Bad News".