A reprint from *Morningstar* magazine

Morningstar

The magazine of independent research for the world's financial professionals Spring 2019

A Steady Lodestar

The world has changed, but the Polaris approach remains constant.

UNDISCOVERED MANAGER

Laura Lallos is the managing editor of *Morningstar* magazine.

Reprinted from *Morningstar* magazine
Spring 2019

A Steady Lodestar

The world has changed, but the Polaris approach remains constant.

UNDISCOVERED MANAGER

Laura Lallos

In every issue, Undiscovered Manager profiles a noteworthy strategy that hasn't yet been rated by Morningstar Research Services' manager research group.

When Bernard R. Horn, Jr. started investing globally more than 30 years ago, it was a painstaking process. "I would take data from *Capital International Perspective*, then the only broad publication of companies worldwide, and type it into my Apple II computer," he recalls. "I used that to create a global valuation model that determined the most undervalued countries and industries."

Once the numbers were crunched and leads identified, it was back to the book. "I'd run my finger down the column—that was the screening technology—to find the least costly company." Horn would turn to snail mail to request an annual report. Then, it was a matter of translating both the language and accounting standards that varied quite widely from country to country. And that was just the starting point.

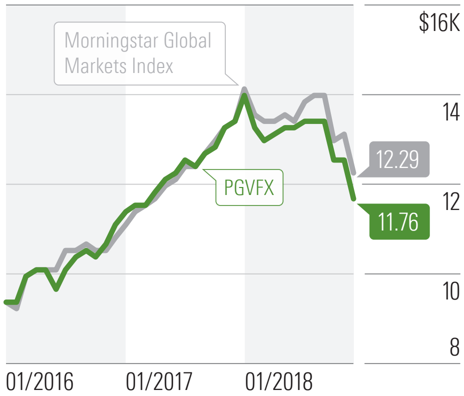
"Fast-forward 35 years," Horn says, "and we have a database of more than 40,000 companies, with all financial statements. We've created algorithms that incorporate our investment intelligence. Within minutes, it will spit out a couple of thousand companies that appear to be priced to beat the benchmark, and then we roll up our sleeves." That's when the fundamental research begins.

Bernard R. Horn Jr., president of Polaris Capital Management.

Reprinted from *Morningstar* magazine
Spring 2019

Polaris Global Value Fund PGVFX

Growth of $10K



Category	World Large Stock
Morningstar Rating	★★★★
10-Yr Annlzd Return (%)	11.91

Source: Morningstar Direct. Data as of 12/31/2018.

The initial process may be faster, but the philosophy remains the same: Find the best individual companies, wherever they may reside, and invest for the long term. The result is an all-cap, low-turnover, bottom-up strategy that sets the firm's flagship fund Polaris Global Value Fund PGVFX apart from other world-stock funds.

Today, Horn carries out his research with a team of eight assistant portfolio managers and analysts at Boston-based Polaris Capital Management, which he founded in 1995. The diversity of the team, he says, "reflects the idea that we invest globally, so we have to have a global team." His first hire in 2002 was Sumanta Biswas, who grew up and was educated in India, and was an officer of the Securities and Exchange Board there. Bin Xiao joined in 2006, bringing a background and education in China. Biswas, Xiao, and Jason Crawshaw, who joined in 2014, are assistant portfolio managers today.

The team's diverse slate of talent was one draw for Sylvia Callan, a portfolio manager with Gage-Wiley, a brokerage firm in Northampton, Mass. She has worked with Polaris Global Value since 2013, using it in separate accounts for the firm's New England Capital RIA clients.

"Bernie believes that if you put in the work you can get the right value without chasing growth or buying value traps," Callan says. "And it's not just him; it's his managers and analysts. He's building up the next layer."

The senior members of the investment team are all owners of the firm, as well as shareholders in the funds they manage. Horn has more than $1 million invested in Polaris Global Value, according to the latest SEC filing, as do two of the three comanagers. The younger generation includes Horn's daughter and son, both analysts. Horn says that signals "a long-term perspective on the future of the firm. It is not going to be sold off to a big asset manager."

As the team has grown, Polaris has remained focused on its core strength. Polaris Global Value, which was born as a limited partnership in 1989 and became a publicly available mutual fund in 1998, remains the only fund offered directly by Polaris. The team does subadvise several funds, where the team is able to leverage a component of the firm's existing expertise. They include Pear Tree Polaris Foreign Value Small Cap QUSIX, which has a Morningstar Analyst Rating of Bronze. Morningstar manager research senior analyst William Rocco cites "a seasoned management team and a sound, distinctive strategy" as key components of that rating.

Cash Flow Is King

At the end of September, Polaris had nearly $14 billion in assets under management, including almost $5 billion in its global multi-cap strategy. That includes the Polaris Global Value Fund, which has grown slowly to more than $400 million in assets, with minimal marketing. "We are a 25-year overnight success story!" Horn jokes.

The flagship fund encompasses the breadth of the team's process. While the fund currently lands in Morningstar's world large stock category, its average weighted market cap of $16.1 billion is well below the category norm. (The fund has in the past fallen in world small/mid stock category.) That market-cap profile was one draw for Callan, who believes that Polaris Global Value's significant stake in mid-cap stocks is a good way to add alpha in strategic fund accounts: "Large-cap stocks tend to be too much like the market, and small-cap international stocks can be risky." She says that the strategy's relatively small asset base leaves it more able to take advantage of such opportunities.

As for regional weights, Callan says, "We like leaving the allocation of U.S. versus international to them because we trust they will find the best places." The fund's regional weightings do not hew to those of its benchmark, the MSCI World Index. It had less than 40% in North America at the end of September, for example, versus 66% for the index.

This is a function of the valuation screens, says Horn, noting that since the financial crisis, lower-valuation stocks have tended to be lower quality in the United States than elsewhere; in the past, the U.S. stake has exceeded 50%. Today, the fund is overweight European markets, as well as developing Asia markets. Meanwhile, it has a noticeable bent toward financial services and is underweight in information technology.

These portfolio statistics are an outcrop of individual stock-picking. "We are completely agnostic as to countries, industries, sectors, and size," Horn says. "The only thing that determines the value of an investment is how much cash flow that investment will throw off."

Keeping Watch

Horn and the team maintain a watchlist of about 250 companies that stand to benefit from fundamentals such as competitive advantages, favorable industry conditions, and capable management. Horn also attributes some of the strategy's success to analysis of pricing power relative to inflation: "This is an area where we've spent a lot of time over the past 10 to 15 years, and it has led us to reject certain names that would normally be in a value manager's portfolio."

Stocks that meet the valuation criteria are added to the portfolio—where they may remain for years. UnitedHealth Group UNH, for example, has been in the fund since 2004, along with 14 other stocks. When it was first added, health insurance stocks were cheap, owing to concerns that premiums would be regulated. Horn believed that UnitedHealth had the expertise to control costs—and it turns out, it has been able to raise premiums over the years as well, allowing for considerable growth of cash flow. While UnitedHealth is no longer the cheapest stock in the portfolio, that cash flow earns it a continued place.

While the portfolio is built stock by stock, the team also aims for a certain level of diversification with a mix of investments that have low correlations with each other. The result is a portfolio of about 75 stocks. The weights are not quite equal; smaller-cap stocks might be weighted less for liquidity reasons, for example. That said, there are no outsized holdings: Typically, no company accounts for more than 5% of assets.

Allocations may be adjusted as valuations change. Valuation may also be a reason to sell altogether: The team added Australian oil- and gas-services provider WorleyParsons WOR:AU to the portfolio when oil prices had collapsed; the stock was recently sold after conditions improved and it was trading at a takeover premium.

Shifting fundamentals also affect buy-and-sell decisions, as was the case with Kansai Electric Power 9503:JP. After Japan shuttered nuclear plants in the wake of the Fukushima nuclear disaster in 2011, Kansai turned to high-priced oil to generate electricity. When Polaris recalculated its cash flow, the model said sell. However, the fund bought the stock back in 2017, as it became clearer that the company would be allowed to restart its nuclear plants.

Sometimes, a pick calls for patience—such as L Brands LB. "That's one of my favorite disasters!" laughs Horn. The team added the name in late 2017, believing that poor sales at Victoria's Secret had hit bottom. Instead, problems have persisted, and L Brands is proving a challenging investment. Horn added to the position in 2018, however. He remains encouraged by management's focus on the issue and points to the company's manufacturing logistics chain as an underappreciated asset that allows the company to keep an array of products in a variety of sizes on the shelves.

Horn will tolerate short-term underperformance with the expectation of long-term gain, but the goal is to beat the benchmark with less risk. Recent addition Korean Tobacco & Ginseng 033780:KR illustrates how this desire to minimize volatility plays into picks. Polaris' value screens have been highlighting Asian stocks, but in countries such as China and India, stocks also have high betas relative to the benchmark.

"Given the choice," Horn says, "we'll take the undervalued company with the low beta. As a result, we've been spending a lot more time in Korea." There, the fund has investments in semiconductors, auto parts, a bank, and now KT&G, the dominant cigarette maker. The team expects it to benefit from a growing consumer preference for heat-not-burn technology.

"KT&G may be one of the lowest-beta stocks I've ever come across in my career," Horn says. "No matter what happens to the economy, people are still going to smoke. We wanted to build in a lot of potential risk, so we used a relatively high discount rate. But the stock is so cheap that even if overall cash flows go down, it is still priced to give a pretty high return."

In It for the Long Haul

Long-term Polaris Global Value shareholders have enjoyed strong performance: Over the 10-year period through December, the fund returned an annualized 11.91%, versus 9.67% for the MSCI World Index and 9.27% for the world large stock category. It also beat the 10.91% return of Morningstar's world small/mid stock category, where it has fallen in the past. One advantage has been a fee waiver in place since January 2014 that has kept expenses at 0.99%, below the average for no-load world-stock funds.

While the fund's standard deviation was higher than the benchmark's, its risk-adjusted performance was superior by measures such as the Sharpe and Sortino ratios. The fund's 4-star Morningstar Rating as of December indicates its strong risk-adjusted performance relative to funds in its category over the past decade.

The fund has not always had a cost advantage, but it has been a consistently strong performer since it opened as a mutual fund in 1998. Its three-year rolling returns over the past 20 years beat both the benchmark and its category average 77% of the time. Over that period, the fund has an upside capture of 107% of the benchmark's return and a downside capture rate of only 91%.

The fund's bouts of underperformance include 2018, when its underweight in the U.S. held it back. It also fell behind in the 2007–09 financial crisis. Positions in U.K. homebuilders crashed, and the fund's heavy financials stake weighed it down. In both cases, however, the fund held fast, to its advantage during the recovery.

At more than 25% of assets—significantly higher than the benchmark and category weights—that financials stake is emblematic of the Polaris go-anywhere approach. Historically, Horn says, the fund did well investing in small-cap U.S. banks that converted from mutual to stock ownership, but today they are priced at takeover premiums. Large-cap banks under fire are better deals, and the fund added JPMorgan Chase JPM in 2016, choosing it over higher-beta stocks like Citigroup C.

While Horn believes U.S. banks are better capitalized and able to withstand crisis than banks in other parts of the world, he says that select banks in Europe and Asia with good management teams avoided credit problems even through the financial crisis. He singles out Norway's DNB DNB:NO, the largest bank in Norway, and SpareBank 1 SR SRBANK:NO, a small savings bank with clean balance sheets that are strong growers, much like their U.S. counterparts.

Global investors willing to follow Polaris wherever its value orientation leads may find this fund a good fit. Callan, for one, has been happy with the results so far: "It's an asset for them to have an all-cap mandate; we are comfortable letting them go with it." M

Laura Lallos is managing editor of *Morningstar* magazine.

	2019					Annualized as of December 31, 2019						
	YTD	QIV	QIII	QII	QI	1 Yr	3 Yrs	5 Yrs	10 Yrs	15 Yrs	20 Yrs	ITD*
Polaris Global Value Fund	22.79%	9.09%	-1.16%	3.17%	10.38%	22.79%	8.96%	7.96%	10.81%	6.82%	8.26%	9.45%
MSCI World Index, net dividends reinvested	27.67%	8.56%	0.53%	4.00%	12.48%	27.67%	12.57%	8.74%	9.47%	6.92%	4.50%	6.80%

* 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 1.23%. The Fund’s annual operating expense ratio has been reduced to 0.99%, effective as of January 1, 2014 through April 30, 2020, 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 December 31, 2019, 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
Babcock International Group PLC	2.0%	Taylor Wimpey PLC	1.7%
Hannover Rueck SE	1.8%	Microsoft Corp.	1.6%
JPMorgan Chase & Co.	1.8%	Mondi PLC	1.6%
The Western Union Co.	1.7%	SKF AB, Class B	1.6%
Bellway PLC	1.7%	Bancolombia SA	1.5%

Before investing, you should carefully consider the Polaris Global Value 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.

The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. As of 12/31/19, the Polaris Global Value Fund received star ratings based on risk-adjusted returns in the US Fund

World Large Stock Category. For the Overall period, it was rated 3 stars out of 722 Funds, 3-year period 2 stars out of 722 Funds, 5-year period 3 stars out of 605 Funds and for the 10-year period 4 stars out of 362 Funds.

The Polaris Global Value Fund is managed by its Investment Adviser, Polaris Capital Management, LLC, which makes investment decisions for the Fund. Polaris Capital Management, LLC oversees $13.7 billion as of 12/31/19.

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

This is not an offer for Pear Tree Polaris Foreign Value Small Cap Fund.

The disclosure page must accompany the Spring 2019 Morningstar Magazine's article entitled "A Steady Lodestar".

POLARIS GLOBAL VALUE FUND