

Masters' Select Smaller Companies MSSFX

Morningstar's Take | 1-11-10 | by Greg Carlson

Is this fund on the way to delivering on its potential?

Masters' Select Smaller Companies is catching up to the pack. But is it capable of running with the leaders?

A blowout 2009 must have been a relief for shareholders of this fund after a very poor showing in 2008 and a bad 2006 relative to its benchmark, the Russell 2000 Index. The fund soared 51% for the year, compared with a 35% gain for its typical small-growth peer and a 27% gain by the Russell. Most of its five subadvisors appear to have posted huge gains (overseer Litman/Gregory doesn't comment on the performance of individual subadvisors), judging by the performance of their own funds. (Each manager contributes just nine to 15 of his favorite stocks to this fund; each runs 20% of its assets.) For example, the managers of CNI Charter RCB Small Cap Value RCBAX, which had a dreadful 2008 because of some hard-hit financials picks, stuck to their guns and rang up a 58% gain at that fund in 2009.

The one subadvisor who appeared to have a very poor 2009 was Bill D'Alonzo of Friess Associates. The manager of mid-growth Analyst Pick Brandywine BRWIX, D'Alonzo here uses a small-growth approach similar to one that his firm uses to manage separate accounts. The firm is focused on companies with relatively strong profits, a strategy that has struggled mightily in the turbulence of the past two years. But the firm's long-term small-cap record is strong.

The fund's recent surge has brought it pretty close to the Russell 2000 since its 2003 inception. (It lags the index by an annualized 1.2 percentage points.) Of course, outperformance is expected here, given the fund's status as an Analyst Pick. That's still a likelihood: Each subadvisor has a fine long-term record and runs a manageable amount of money, and three have been on board since the fund's inception. This offering can be volatile, but it's a worthy small-cap holding.

Morningstar Rating

★★

Kudos

- Topnotch management team.
- Fund is small and will close at a conservative level.

Risks

- Masters' Select funds are concentrated and tend to be more volatile, as measured by standard deviation, than their category peers.
- Two subadvisor changes at this six-year-old fund speak to the difficulty of choosing small-cap managers.
- Subpar performance since its 2003 inception relative to its benchmark.

Strategy

Litman/Gregory Advisors divvies up assets among five subadvisors, and each picks nine to 15 stocks according to his own investing style. Broadly speaking, Bob Rodriguez and the duo of Jeff Bronchick and Tom Kerr are value managers; Bill D'Alonzo and Tucker Walsh favor growth stocks; and Dick Weiss falls in between, but all have the flexibility to invest in stocks that don't neatly fall into one bucket or the other. Litman/Gregory isn't dogmatic about the fund's market-cap limits, so there will be a number of smaller mid-caps here.

Management

Five managers with experience running small-cap funds call the shots here. Former Morningstar Manager of the Year Bob Rodriguez is taking a year off, but the rest of the strong team from FPA Capital is part of a solid roster that also includes Bill D'Alonzo of Brandywine and Dick Weiss (formerly of Strong and Wells Fargo Advantage funds). Most of the team from a fourth subadvisor, Copper Rock Capital Partners, led by Tucker Walsh, runs Old Mutual Copper Rock Emerging Growth OMZRX, and Jeff Bronchick and Tom Kerr of Reed, Conner & Birdwell manage CNI Charter RCB Small Cap Value.

Role in Portfolio

Supporting Player. Although the fund resides in the small-growth category, the broad mix of styles used by its subadvisors makes it appropriate as a core small-cap holding.

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Year	Total Return (%)	+/-Category
YTD	4.47	1.38
2009	50.57	13.04
2008	-44.81	-2.06
2007	1.64	-7.92
2006	9.68	-1.00

Data through 12-31-09