

## The 2005 Morningstar Fund Managers of the Year

### Fund Spy

by Russel Kinnel

#### These winners put shareholders first—and deliver.

In choosing the winners of the 2005 Morningstar Managers of the Year awards, we were fortunate to have so many good fund managers who did all the right things for shareholders in a wide variety of markets.

In 2005, the markets certainly made a case for diversification. Soaring energy and precious-metal prices burned bonds, which hate inflation. As a result, the bond market had a cold year in which funds were lucky to earn 2%. Foreign stocks, fueled by those same commodities and reforms in key markets, produced hot returns averaging 17%. Finally, the typical domestic-stock fund returned a lukewarm 7%.

You might expect that this environment would cause us to diversify with our three Manager of the Year selections, possibly choosing a bear for fixed income, a bull for foreign stocks, and someone in between for domestic equity. But while we certainly look for managers who had great one-year showings, they also must have produced superior results over a long period of time—a single great year won't cut it. The surest way to making a lot of money for shareholders is to string together a bunch of modest victories in order to produce strong results over the long haul.

We also look closely at how seriously a manager takes his or her fiduciary duty to shareholders. In the long run, shareholder orientation is closely linked to shareholder returns. We look for managers who put shareholders first when it comes to fees, communication, their own investments in their funds, closing their offerings in a timely fashion, and other important issues. A strong Stewardship Grade is therefore a prerequisite for any Manager of the Year contender.

We're encouraged that so many great managers passed all those tests. It made for very difficult decisions this year. You could make a strong case for a number of managers, but we only chose one for each of the three broad asset classes: domestic stocks, foreign stocks, and fixed income.

It's also worth noting we've been fans of these funds for a long time. Our domestic winner has been a Fund Analyst Pick since we launched the picks in 1999. Our bond winner has been a pick since 2001, and our foreign winner has been a pick since 2004 and runs a domestic fund that has been a pick since 1999.

#### Domestic-Stock Managers of the Year: Chris Davis and Ken Feinberg

##### Selected American SLASX and Davis NY Venture NYVTX

In 2005, Chris Davis and Ken Feinberg's abilities really came to the fore. Although it was a treacherous year for financials, this financials-heavy fund was able to thump the S&P 500 and most of its peers. The fund's 10.19% return was far ahead of the 4.91% gain of the S&P 500 because the managers found high-quality financials and some energy stocks that produced remarkable returns.

Because turnover at Selected American and Davis NY Venture is in the single digits in most years, successful stock picks in any single year are actually attributable to work the firm has done over many previous years.

Just as important as these managers' stock investments have been their investments in people. Although their firm is still small, Davis and Feinberg rounded out their analyst staff over recent years with some outstanding hires. For example, Kent Whitaker, who joined Davis Selected Advisers after working for Amoco, has played an important role in finding the energy names that have paid off more recently.

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### Fund spy (cont'd)

We are also impressed by Davis and Feinberg's focus on doing the right thing for fund owners. Their fund fees have long been reasonable, but in 2004, they had a Bogle-esque epiphany. Fund supermarkets charge funds a hefty fee for slots in their no-transaction-fee plans—a cost that funds pass along to shareholders in the form of higher expense ratios. The kicker is that the supermarkets also try to prohibit fund firms from offering a cheaper share class of their funds to their investors who deal directly with the fund company rather than using a supermarket. This has the effect of forcing direct investors to pay higher expenses than they should. Davis finally decided enough was enough. After all, it costs the same to manage different funds even if various sales channels have different costs. Thus, the firm instituted a cheaper, directly sold share class, which resulted in a sizable fee cut for those who invest directly with Selected Funds.

In 2005, the firm also offered **Clipper Fund** CFMX shareholders a nearly 50% cut in their management fee when the Clipper board decided to hire Davis Selected to run Clipper in place of the departing Pacific Financial Research managers. In addition, the Davis crew immediately invested \$50 million of its own money in Clipper. The Clipper board, Davis, and Feinberg raised the bar on how shareholders should be treated. Today there are hundreds of funds where the board should be looking outside the parent company for management or where portfolio managers show a half-hearted commitment to shareholders with a lack of investment in their funds or needlessly high fees. Davis and Feinberg demonstrate that is not how responsible fiduciaries behave.

### Fixed-Income Managers of the Year: Tad Rivelle, David Lippman, Laird Landmann, and Stephen Kane

#### **Metropolitan West Total Return Bond** MWTRX

MetWest takes a creative approach to managing fixed-income assets, and it has produced great results. The firm will adjust its funds' interest-rate sensitivity, shift into different sectors of the bond market, or bulk up on individual bond issues when opportunities present themselves.

The team used corporate bonds to push this fund past its average peer in 2004, and in 2005 it made profitable forays into high-yield bonds, bank loans, and other specialty areas of the market, helping the fund nearly double the return of its average peer. In 2005, the fund's 3.11% return topped 95% of its peer group.

The fund's bold approach burned it in 2002, as a big bet on WorldCom bonds turned sour, but it has since recouped that lost ground and then some as the market has corrected its overreaction to credit risk. The managers have also instituted risk controls that now limit their exposure to any one issuer. Despite a 1% loss in 2002, the fund has delivered an annualized return of 7.22% since its 1997 inception, which easily beats the average intermediate-term bond fund's 5.84% return. That's a huge margin in the high-quality bond world, where a few basis points' worth of outperformance is a big deal.

MetWest also gets an A for stewardship because management invests in the funds and the firm keeps expenses low.

### International-Stock Managers of the Year: Rob Lyon, Matt Pickering, and Jerry Senser

#### **ICAP International** ICEUX

Funny how great stewards can produce great returns. Lead manager Rob Lyon's fund gets four "excellents" and a "good" in our Stewardship Grade scoring—earning it an A for overall stewardship. Although small, the fund has always charged just 0.80% to retail investors (the same amount ICAP's domestic funds charge) even though many fund companies mark up their foreign-fund management fees simply because they can get away with it. Likewise, the fund's board is paid in fund shares. Just as important, ICAP has a healthy corporate culture that has kept turnover among its investment professional staff quite low.

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### Fund spy (cont'd)

Now to performance. This fund has outlegged Europe funds and foreign large-value funds alike since its inception on Dec. 31, 1997. In May 2005, the fund converted from a Europe fund to a broad foreign-stock mandate because management was finding a lot of attractive names in Japan. The move was fortuitous, as Japan enjoyed a strong rally in 2005. Japanese stocks Mitsubishi, Mizuho Financial Group, and Mitsui Fudosan have been a boon to the fund, which returned a stunning 19.15% in 2005. Since its inception, the fund has returned 11.32%.

Lyon and his ICAP colleagues blend top-down analysis with stringent valuation work to find attractive companies with potential. They run a concentrated portfolio of about 35 names, most of them large cap. Lyon brings an unusual wrinkle to that concentrated portfolio of value stocks, though. He trades around positions pretty rapidly based on changes in valuation. Although the companies in the portfolio don't change all that much, their position sizes are always in flux.

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# Metropolitan West Total Return Bond Fund (M-Class) Net Performance

Total Returns as of 12/31/05

	4Q'05	1-Year	ANNUALIZED		
			3-Year	5-Year	Since Inception 3/31/1997
MWTRX <sup>1</sup>	0.23%	3.10%	7.27%	5.95%	7.22%
Lehman Aggregate <sup>2</sup>	0.59%	2.43%	3.62%	5.87%	6.70%

## Yearly Performance

	1999	2000	2001	2002	2003	2004	2005
MWTRX <sup>1</sup>	1.72%	10.20%	9.19%	-0.95%	13.88%	5.15%	3.10%
Lehman Aggregate <sup>2</sup>	-0.83%	11.63%	8.42%	10.26%	4.10%	4.34%	2.43%

<sup>1</sup>Returns for the Fund are net of all charges and fees assuming reinvestment of dividends and capital gain distributions at net asset value. Returns for periods greater than one year are annualized. For Class M, the advisor has contractually agreed to reduce its fees and/or absorb expenses, and to pay a portion of the Fund's distributing expenses to limit the Fund's total annual operating expenses to 0.65% of the Fund's Class M average net assets, which has the effect of increasing the rate of return.

<sup>2</sup>The Lehman Brothers Aggregate Index is an unmanaged index generally representative of a broad range of fixed income securities. The securities that comprise the Lehman Brothers Aggregate Bond Index may differ substantially from those in the Fund's portfolio. An unmanaged index is not available for direct investment. Unlike a mutual fund, the performance of an index assumes no taxes, transaction costs, management fees, or other expenses.

*The performance data quoted represents past performance and does not guarantee future results. Current performance may be lower or higher. Since inception returns are due in part to market conditions which might not be repeated in the future. Performance data current to the most recent month-end may be obtained at [www.mwamllc.com](http://www.mwamllc.com). The investment return and principal value of an investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. The fund offers another class, the performance for which will vary due to fees and expenses.*

This article must be preceded or accompanied by a prospectus for the Metropolitan West Total Return Bond Fund. The prospectus describes the investment objectives, risks, charges, and expenses of the Metropolitan West Funds. Although the funds are no-load, other annual fees and expenses do apply as described in the prospectus. Portfolio holdings and sectors are subject to change without notice.

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The Metropolitan West Total Return Bond Fund (M-Class) was ranked by Morningstar as of 12/31/05 based on Total Return within the Intermediate-Term Bond category. The fund received a percentile ranking of 3%, 1% and 20% among 1063, 901 and 691 funds for the 1-, 3- and 5-Year periods respectively. Morningstar ranks funds from 1 (being the highest percentile rank) to 100 (the lowest percentile rank). A top performing fund will receive a rank of 1 in its category. Past performance is not indicative of future results.

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