

# Sound Shore SSHFX

No problem finding a record to evaluate.

3-13-12 | by Gregg Wolper

A long-term perspective is even more appropriate for Sound Shore fund than for most mutual funds.

Savvy investors know that short time periods provide only a limited portrait of a fund. But when a fund has had changes of management or strategy or has grown immensely in size, the relevant record doesn't go back as far as one would like. That issue does not apply here. This fund has been run by the same managers, using the same strategy, for more than 25 years, and its asset base has almost always been between \$1 billion and \$3 billion for more than a decade. So, it is noteworthy that since its mid-1985 inception, the fund has beaten the S&P 500 Index by a half a percentage point and the large-value category by 1.5 points on an annualized basis. That adds up over such a long period.

Although they're value investors, managers Harry Burn, Gibb Kane, and John DeGulis prefer solid companies undergoing a slow patch (or out of favor because their businesses lack pizzazz) to troubled deep-value plays. For example, they bought Lowe's LOW in the second half of 2011. Kane and DeGulis say that the firm's management was slow to recognize that the housing slump and economic slowdown would require changes to their business but have recovered their stride. Life Technologies LIFE, a leader in the DNA-sequencing field, sounds like a growth stock that wouldn't interest these managers. But doubts about a spate of acquisitions and worries about government funding hit its share price, so they bought it in 2011's fourth quarter.

The fund's long-term record is worth keeping in mind because while it has enjoyed a strong start to 2012, the previous two years were subpar. In 2011, the fund had a rare bottom-quartile ranking,

as the managers' belief that mega-banks Citigroup C and Bank of America BAC were in better shape than most thought hurt the fund when global worries, and specific concerns, sent those stocks tumbling. (They held on, saying they know the banks' revival could take years.) This fund may require patience, but it's a fine choice.

**Process Pillar:** Positive

The managers look for stocks that have solid fundamentals and encouraging prospects but which are out of favor for one reason or another. To find candidates, they and their analysts screen a large number of equities from the United States and abroad to identify stocks trading at large discounts to their historic price multiples. Once the team has narrowed the list, it evaluates a firm's competitive position by speaking with company management, competitors, and customers. The team then prepares detailed financial and valuation models. The result is a portfolio of 40 or so mid- and large-cap companies. Even with such a compact portfolio, though, the fund is not overly concentrated in individual companies as many focused funds are; here, typically no stock gets more than 4% of assets. The managers' willingness to buy companies that most investors are doubting means the fund's stocks sometimes fall further before their value is recognized and sometimes don't recover. While foreign stocks often appear in the portfolio, their number usually is limited to a handful of names; this is overwhelmingly a fund of U.S.-based companies. The managers have a long-term perspective—some stocks in the current portfolio have been there since 2004 and 2005—but will sell when a stock appreciates to their target price or the story changes for the worse, so the annual turnover rate tends to lie around the large-value average of 80%.

**Performance Pillar:** Neutral | Gregg Wolper 03/10/2012

## Morningstar's Take SSHFX

<b>Morningstar Rating</b>	★★★
<b>Morningstar Analyst Rating</b>	Silver
<b>Morningstar Pillars</b>	
Process	Positive
Performance	Neutral
People	Positive
Parent	Positive
Price	Neutral

**Role in Portfolio**

Core

**Fund Performance** SSHFX

Year	Total Return (%)	+/-Category
2011	-6.18	-5.43
2010	12.13	-1.53
2009	26.64	2.51

Data through 12-31-11

**People Pillar:** Positive

Shareholders here get an extraordinary amount of experience and continuity. The managers of Sound Shore have been working on this fund, using the same strategy, for decades. Managers Harry Burn and Gibbs Kane founded advisor Sound Shore Management in 1978 and have led Sound Shore fund since its inception in May 1985. (The private accounts run by the advisor use the same approach as the fund; the firm does not run any other strategies.) They were the sole managers until 2003, when John DeGulis, who had worked with them as an analyst since 1995, was named a comanager of the fund. Burn, Kane, and DeGulis all have more than \$1 million of their own money invested in Sound Shore, a commitment that helps align their interests with the fund's shareholders as much as possible. (The firm's profit-sharing plan also is invested in the fund.) This trio works with four in-house analysts who joined the team between 2003 and 2008, and all are based in their office in Connecticut. Most stocks are researched by teams of two, typically one manager and one analyst. The firm

does little to no marketing of the fund and has come out with no other mutual funds.

**Parent Pillar:** ⊕ Positive | Gregg Wolper  
10/03/2011

This firm has some attributes that many other fund companies would be wise to emulate, in part if not in whole. Sound Shore Advisors was founded in 1978 by Harry Burn and Gibbs Kane, two of the portfolio managers of Sound Shore SSHFX, and it is still owned and run by them. The firm offers just one mutual fund, and its only other business is running separate accounts in the same style. The firm doesn't do any advertising and does very little marketing. The fund managers spend only minimal time on any sort of marketing activity.

The firm had \$5.2 billion under management as of Sept. 30, 2011, with slightly more than half of that in separate accounts. Its managers and analysts stick around; there has been no manager turnover—Burn, Kane, and John DeGulis, who has been with the firm since the 1990s, are the three managers—and little change among the analyst staff, which now numbers four. The three managers each invest more than \$1 million in fund shares, demonstrating industry-leading skin in the game.

The one area that could stand improvement is shareholder communications. Shareholder reports are candid about specific holdings, but they are not as lengthy or detailed as they could be, especially when compared with the best reports from small shops committed to a distinctive style, such as Third Avenue.

**Price Pillar:** ● Neutral

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**SOUND SHORE FUND**

## **Important information Regarding Morningstar's Take:**

### **Morningstar Rating: Overall 3 Stars**

The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its three-, five-, and ten-year Morningstar Rating metrics.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each 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. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating for a fund is derived from a weighted-average of the performance figures associated with its three-, five- and ten-year (if applicable) Morningstar Rating metrics.

Sound Shore was rated against the following numbers of U.S.-domiciled Large Value funds over the following time periods: 1098 funds in the last three years, 973 funds in the last five years, and 570 funds in the last ten years. With respect to these Large Value funds, Sound Shore received a Morningstar Rating of 2, 3, 3 stars for the three-, five- and ten-year periods, respectively. Past performance is no guarantee of future results. **The fund experienced negative performance during some of the periods referenced.** Data as of 3/31/2012.

### **Morningstar Analyst Rating**

The Morningstar Analyst Rating is not a credit or risk rating. It is a subjective evaluation performed by the mutual fund analysts of Morningstar, Inc. Morningstar evaluates funds based on five key pillars, which are process, performance, people, parent, and price. Morningstar's analysts use this five pillar evaluation to identify funds they believe are more likely to outperform over the long term on a risk-adjusted basis. Analysts consider quantitative and qualitative factors in their research, and the weighting of each pillar may vary. The Analyst Rating ultimately reflects the analyst's overall assessment and is overseen by Morningstar's Analyst Rating Committee. The approach serves not as a formula but as a framework to ensure consistency across Morningstar's global coverage universe.

The Analyst Rating scale ranges from Gold to Negative, with Gold being the highest rating and Negative being the lowest rating. A fund with a "Gold" rating distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. A fund with a 'Silver' rating has notable advantages across several, but perhaps not all, of the five pillars-strengths that give the analysts a high level of conviction. A "Bronze"-rated fund has advantages that outweigh the disadvantages across the five pillars, with sufficient level of analyst conviction to warrant a positive rating. A fund with a 'Neutral' rating isn't seriously flawed across the five pillars, nor does it distinguish itself very positively. A "Negative" rated fund is flawed in at least one if not more pillars and is considered an inferior offering to its peers. Analyst Ratings are reevaluated at least every 14 months.

For more detailed information about Morningstar's Analyst Rating, including its methodology, please go to:

<http://corporate.morningstar.com/us/documents/MethodologyDocuments/AnalystRatingforFundsMethodology.pdf>.

**The Morningstar Analyst Rating should not be used as the sole basis in evaluating a mutual fund. Morningstar Analyst Ratings are based on Morningstar's current expectations about future events; therefore, in no way does Morningstar represent ratings as a guarantee nor should they be viewed by an investor as such. Morningstar Analyst Ratings involve unknown risks and uncertainties which may cause Morningstar's expectations not to occur or to differ significantly from what we expected.**