

BARRON'S Mutual Funds

FOR THE WEEK NOVEMBER 11 THROUGH NOVEMBER 15, 2002

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A Bull In Waiting

John C. Thompson is ready to
steer Thompson Plumb Growth
out of the barn

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John Sibiak for Barron's

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performance. The fund is up more than 12% this year, outdistancing other small-cap value funds by a stunning margin. Of the 254 funds in Morningstar's small-cap value group, the next best is just a fraction over break even.

Dreifus, a Baruch College graduate who has been running money since 1968, is a self-proclaimed disciple of Abe Briloff, the legally blind 85-year-old Baruch accounting professor who has been preaching the gospel about the dangers of creative accounting since, well, anyone can remember—And doing so in the pages of *Barron's*, by the way.

His approach starts with buying inexpensive securities: Dreifus says he uses "the most severe M&A metric," enterprise value divided by trailing 12-month earnings before interest and taxes—EBIT, that is, without the DA, depreciation and amortization. What he's looking for is evidence that the company is producing a return that's greater than the cost of capital.

He also wants to see good businesses—franchises—as evidenced by a high return on capital. "It's a sign that a company has unique pricing power, something inherently different to get that higher rate of profitability," he says.

The final element, he says, is where Briloff comes in. "He instilled in me a search for veracity, for integrity in the numbers," he says.

As it happens, now everyone's doing it. "Enron and other scandals have led people to embrace the things which have always been important to me," Dreifus said in a telephone interview last week. "Many of my companies have a strong family that not only owns a big chunk of the company but also tends to quite conservative. They tend to pay dividends, and they tend to buy stock back. All these things were thought of as negative in 1999. But people have gotten the old-school religion. They have come back to my stocks."

Dreifus tends to avoid tech stocks, and since "very few are making money," and shies away from banking and insurance stocks, dismissing them as "spread businesses" that may not be worth the inherent risks.

Flooded with new money, Royce Special finished the month of October more than 25% in cash, up from 18.5% a month earlier. Had more of it been invested he might be up even more. Dreifus hastens to say that he was not making a market call, but rather moving carefully to maintain price sensitivity while putting the new dollars to work. While he's skittish about detailing the fund's holdings, the Royce Website shows the largest bets at the end of October include many consumer names; topping the list were sneaker maker K-Swiss, Universal Corp., a leaf tobacco merchant, Bandag, which makes supplies for retreading tires, gift maker Russ Berrie and National Presto, known for kitchen gizmos.

Note that this fund is in fact still open for new money, which is not true for some other small-cap value funds after a strong performance by the group over the last two years. But it won't stay open forever. Include all the cash Dreifus runs in Royce Special, an offshore clone and some separate accounts, and he's managing \$470 million. At some point before the total hits \$1 billion, Dreifus says, he'll stop taking new money. So if you like this one, know that the clock is ticking. ■

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Contrary Call

Thompson Plumb Growth seeks what others sell

BY RICHARD KARP

JOHN C. THOMPSON, CO-MANAGER OF the \$480 million Thompson Plumb Growth Fund, is a contrarian investor almost to the point of religious devotion. Consider his aggressive purchase of Viacom in the aftermath of the Sept. 11 terrorist attacks, when the stock was tumbling to 31 from 60 amid a brutal advertising recession. In due course, Viacom became the mutual fund's biggest holding, although it didn't enjoy that honor for long. The company's advertising revenues and earnings recovered much sooner than expected, and Thompson, 34, sold his entire position in April at \$50 a share, for a handsome 61% gain.

Examples such as this—and there are many—go a long way toward explaining why \$10,000 invested in Thompson Plumb Growth in May 1992 grew to \$48,804 by May 2002, compared with a growth to \$31,297 in the Standard & Poor's 500 Index for the same investment over the same span. The Lipper rating service accords the fund a No. 1 billing among multi-cap core funds for its consistent returns, and a No. 2 rating (the second quintile) for capital preservation in the same group, notwithstanding some recent setbacks.

Morningstar gives the fund five stars, its top rating in the "large blend category." Langdon Healy, of the Chicago-based rating service, calls Thompson Plumb Growth "an excellent growth fund and fairly conservative," but warns that its manager's willingness "to look at out-of-favor stocks... leads to erratic performance short term."

To Thompson, whose father, John W. Thompson, founded the fund in 1992, that sounds like a compliment. "It's human nature to buy when news is good and sell when news is bad," he says. "But we go against human nature. We try to buy when there is bad news, and sell when there is good news."

It's a stressful life. In the late 1990s, at the height of the Internet bubble, Thompson says he felt like "a square peg in a round hole. The market was doing things that we just couldn't comprehend."

Early in 2000, for example, Thompson was sitting by a Bloomberg machine, eyeing the action on a stock called Inktomi. According to the screen, the company had a market value of \$40 bil-



John C. Thompson: "We beat the Standard & Poor's 500 index over the past decade because we didn't buy the Inktomis of the world."

lion. Suddenly, news scrolled across the bottom of the screen that the venerable St. Francis Hotel in San Francisco had just been sold for more than \$240 million in cash. "I said to myself, 'What is wrong with the world if one of the best hotels in America is selling for less than 1% of the value of a company that is a year or two old, with very little revenue?'" he recalls.

Inktomi now trades on the Nasdaq for 71 cents per share; its market capitalization has shrunk to \$115 million. "So, if you want to know the reason we beat the S&P 500 over the past decade, it's because we didn't buy the Inktomis of the world," Thompson says.

The same is more or less true of

Yahoo, an S&P 500 component that at its peak was valued by the market at double the worth of General Motors, Ford and Chrysler—combined. "It's still in the S&P, but it sure made the S&P easier to beat," he quips.

Even as the stock market wobbles in anticipation of a "double-dip" recession, Thompson is sticking to his contrarian guns. Indeed, bad news only whets his appetite. No sooner did the manager of Thompson Plumb Growth sell his Viacom position six months ago than he switched into AOL Time Warner, making that one of his top ten holdings. And what attracted him? Other investors' skittishness about the

AT A GLANCE

Thompson Plumb Growth

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TOP 10 HOLDINGS

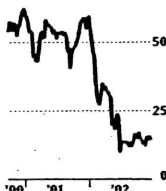
Company	Percentage Of Portfolio*
Microsoft	6.37%
Merck	5.64
Bristol-Myers Squibb	4.96
Hewlett-Packard	4.75
Clear Channel Comm	3.30
TOTAL	48.46%

*as of 10/13 Source: Thompson, Plumb & Assoc.

TYCO INTERNATIONAL

TYC • NYSE Price

.....\$75



company's accounting problems.

Thompson bought AOL at \$18 a share, and it since has fallen to 15, denting his portfolio in the process. But he's sticking with the media and Internet conglomerate. "In a prospective economic recovery, with some of the bad accounting news past, the stock will trade up to the mid-\$20s," he says.

Compared with similar companies, Time Warner's bundle of media assets is worth \$15 to \$18 a share, Thompson wagers. Put another way, AOL probably would get \$20 per share for Time Warner's entertainment properties, should it decide to sell them.

Unlike most investors, Thompson still considers AOL a good business. "We are keeping it, and so should Time Warner," he says. Time Warner is expected to earn as much from AOL as from the imminent release of two movie sequels to "Harry Potter" and "Lord of the Rings," he notes.

Radio and billboard owner Clear Channel Communications is another of the fund's ten largest holdings. Thompson bought the stock in recent years for an average price in the high \$40s; when it collapsed to 25 this August, he doubled his position.

What charmed his inner contrarian? Despite the stock's volatility, Clear Channel is in a business that has been remarkably stable over both the short and long term. So why are the shares getting hammered? Thompson blames "market psychology," which has become "way too bearish for this industry."

Despite its manager's fascination with down-and-out media companies, Thompson Plumb Growth is a highly diversified fund. Another of its major holdings is Gap, the ubiquitous specialty-apparel retailer, whose fashions have gone in and out of style over the three decades it's been in business. Thompson snared the stock at an average price of \$12.50 per share, but watched it retreat to \$10.50 before rebounding recently, to \$14. (Gap was the subject of a story in last week's *Barron's* saying the company's set for a comeback.)

Gap's current woes are due largely to yet another fashion misstep: In the late 1990s, the company's classic denim and khaki looks took a back seat to leather pants and other high-fashion togs—the sort of stuff that "only people in New York and San Francisco wear," Thompson remarks from his perch in Madison, Wis.

But now Gap is returning to its roots with jeans and cowboy shirts, which apparently are in demand again. What's

more, Gap has enormous operating leverage; a marginal improvement in sales could translate into earnings that soar. "It may sound crazy, but we don't see why Gap shouldn't sell in the \$30-to-\$40 range in the next three years," Thompson says.

Another of the manager's favorites is CIT Group, a commercial lender spun off from Tyco in July, in an initial public offering priced at \$23 a share. Thompson bought in on the IPO, and the stock became the fund's 12th largest holding. CIT now trades at about \$20, although the company has a tangible book value of \$21 per share. In an economic recovery, Thompson says, the stock could trade for as much as 1.5 times book, catapulting it into the \$30s. If CIT fixes some problems in its loan portfolio, the company might even be bought out in two or three years at three to four times book, much as Citigroup acquired Associates First Capital.

Thompson Plumb Growth's biggest holding is Microsoft, for which the fund paid an average price of \$55 a share. The stock is now at \$57.

"Like it or not, Microsoft is what economic textbooks would call a 'natural monopoly,'" he says.

Antitrust suits may be an ongoing worry, but Thompson thinks the government made big mistakes in trying to introduce competition into similarly monopolistic industries such as telecommunications and electric utilities. He doesn't expect Microsoft to revisit its high of \$122 per share, "but it might rise significantly more than the stock market in the next few years," he says.

At the least, he expects Microsoft to benefit in a debt-burdened era from a balance sheet graced by almost \$50 billion in cash and equivalent investments.

It is no surprise that the market's few remaining momentum stocks have no place in Thompson Plumb Growth's portfolio. Harley-Davidson, the motorcycle maker, is celebrating its 100-year anniversary, with sales up 30% and its stock currently trading at \$50, close to the all-time high.

But, asks Thompson, who is short the stock in his personal portfolio, "What about next year?"

By his reckoning, there is a finite market for \$20,000 motorcycles, and it is likely to grow smaller in light of the consumer's burgeoning debt and eroding confidence. Then again, "the market has to have something to dream about," he says.

Ironically, Thompson Plumb Growth's contrarian dreams have hurt the fund this year; its returns fell 20.6% for the year to date; the S&P is down 20.1%.

Unfortunately, Thompson remained bullish on many downtrodden issues this summer, even after other investors began to worry about a double dip, knocking these shares lower still. Again. According to Lipper, the fund gained 0.09% in the past four months.

But there's a bright side to this year's disappointments. "The bear is pretty much out of the barn, so to speak," Thompson says. Behind the barn door waits an eager bull. ■

FUND SCOPE

Good Week, Awful Year

► Science and technology funds bounded up 2.52% in the latest week, following gains by industry leaders Dell, Intel and Cisco. The group's gains helped large-cap, diversified U.S. growth funds rise 0.59%. Despite last week's good news, the science and technology group is still down 39% this year.

—Erin E. Arvedlund

Fund Name/Manager	Phone Number	Load	Assets (millions)	YTD Return	3 Year Return*
T Rowe Price Sci&Tech Shs	800-225-5132	None	\$2,855.0	-35.95%	-32.84%
Michael F. Sola					
Fidelity Sel Electronic	800-544-8888	3	2,281.3	-45.75%	-24.52%
Samuel J. Fields					
Seligman Communictn A	800-221-7844	4.75	1,870.3	-33.76	-19.05
Paul Wick					
W&R Adv Science & Tech A	888-923-3355	5.75	1,652.8	-26.89	-9.97
Anthony H. Shafan					
Fidelity Sel Technlgy	800-544-8888	3	1,441.1	-33.20	-26.00
Sonu Kalra					
Alliant Technology B	800-227-4613	None	1,376.3	-40.31	-18.72
Archie Malgou					
Janus Gbl Technology	800-525-8983	None	1,250.0	-36.57	-29.90
Mike Lu					
WVESCO Technology Inv	800-526-8085	None	958.3	-41.57	-19.48
William K. Schell					
Scudder Technology A	800-621-1048	5.75	886.9	-34.97	-25.47
Horton/Treisman					
Sel Sector Tech SPDR	800-843-2639	None	863.9	-34.78	-29.54
John Buckner					

*Annualized. All data through Thursday.

Source: Lipper

SCOREBOARD

Creeping Ahead

► Stocks inched higher for the week through Thursday, despite downgrades of several high-profile stocks, a terror warning and a government report signaling that inflation could be on the rise. Domestic diversified stock funds as a group gained 0.19%, slightly more than the broader market, which edged up 0.18%. Small-cap core funds led other sectors, gaining 1.15%. Science and technology funds shot ahead 2.52%, and Japanese regional funds lost 5.25%, according to Lipper. Among the 25 largest funds, Janus gained 0.54%; Fidelity Growth, 1.26%.

—Erin E. Arvedlund

	One Week	Year-to-Date
U.S. STOCK FUNDS	0.19	-21.02
U.S. BOND FUNDS	-0.05	3.88
TOP SECTOR / Technology	2.52	-39.29
BOTTOM SECTOR / Japanese Funds	-5.25	-17.14

Fund	Investment Objective	One Week	Year-to-Date
Frontier Equity Fund	Small Cap Core	9.09%	-36.28%
iShares GS Network Idx	Telecommunication	7.06	-55.90
iShares Sweden	European Region	6.48	-25.22
Fifth Technology Inst	Technology	6.24	-39.25
Wireless Wireless Fund	Telecommunication	6.22	-52.67
Fidelity Sel Netw&Inf	Technology	6.12	-47.12
ProFunds Semiconduct Inv	Technology	5.94	-61.46
Rydex Dynamic Vc 100 H	Multi Cap Growth	5.85	-62.76
ProFunds UltraOTC Inv	Multi Cap Growth	5.81	-63.87
RS Inv Internet Age	Technology	5.44	-39.41

Fund	Investment Objective	One Week	Year-to-Date
Fidelity Sel Medical	Health/Biotech	-10.72%	-8.83%
TCW Galileo Jap Eq Instl	Japanese	-8.83	-30.15
ProFunds UltraJapan Inv	Japanese	-8.78	-40.81
Matthews Asian Japan	Japanese	-8.47	-16.32
ProFunds Prec Metals Inv	Gold Oriented	-7.69	NA
The Japan Fund S	Japanese	-7.42	-13.42
ProFunds UKSht OTC Inv	Spec Dvsd Equity	-7.25	34.64
Rydex Dynamic Vn 100 H	Spec Dvsd Equity	-7.15	36.75
Crtd Suis Jp Gro Cm	Japanese	-7.14	-30.13
T Rowe Price Int Japan	Japanese	-6.53	-19.50

Fund	Net Assets (billions)	Investment Objective	3-Year* Return	1-Week Return	YTD Return
Fidelity Magellan Fund	\$58.056	Large Cap Core	-11.90%	0.37%	-20.81%
Vanguard 500 Index Inv	56.226	S&P 500 Funds	-11.99	0.23	-20.15
American Funds ICA A	45.299	Large Cap Value	-3.77	0	-14.58
American Funds Wsh A	41.423	Large Cap Value	-3.17	0.26	-15.65
SPDR Trust 1	40.398	S&P 500 Funds	-12.08	0.23	-20.13
PIMCO Total Return Inst	39.255	Intnd Inv Grade	9.52	-0.10	-7.97
American Funds Gro A	30.948	Multi Cap Growth	-4.95	0.58	-18.98
Fidelity Contrafund	28.013	Multi Cap Growth	-6.42	-1.09	-9.03
Fidelity Gro & Inc	26.677	Large Cap Core	-8.16	-0.80	-16.51
American Funds EuPc A	22.423	International	-10.22	-0.52	-14.55

*Annualized. Through Thursday.

Source: Lipper