

MarketWatch

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MUTUAL UNDERSTANDING

Five low-cost funds that don't skimp on returns

These standout managers have outperformed peers at below-market rates

By Murray Coleman, MarketWatch
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SAN FRANCISCO (MarketWatch)—With mutual funds, it pays to be cheap.

Focusing on fund-management fees and related expenses is a proven way to enhance your returns. After all, the less you spend, the more you're able to keep.

The trick is finding funds with below-average costs that have delivered above-average gains. Using data from investment researcher Morningstar Inc., MarketWatch searched U.S. diversified stock funds open to new investment and with managers in place for at least three years. Performance was measured on short-term and long-term rolling periods and compared with so-called best-fit indexes.

After combing the data, we turned up five no-load funds that not only hold expenses well below their competitors but also boast performance in excess of all but a handful of their peers. And given the real possibility that 2006's double-digit stock-market gains won't repeat in the new year, these solid standouts could make a big difference.

Royce Value Plus Service

Portfolio managers Whitney George and James Skinner have shown a knack for spotting growth at bargain prices, to the benefit of shareholders in their Royce Value Plus Service Fund (RYVPX).

The small-company stock fund's return topped 20% in 2006. That was good enough to beat 95% of its rivals. For the past five years, the fund lands in the top 1% of its class. During that period, it has also outperformed its average competitor by more than 15 percentage points.

Royce Value Plus carries an expense ratio of 1.42%, less than its category's average of 1.67%.

Unlike other value-conscious Royce funds, Value Plus dips into broken growth stocks. It also tends to hold onto its winners longer.

"We've got an intense focus on minimizing downside risk," Skinner said. "We've got a lot of flexibility in that sense to move between micro-cap, small-cap and midcap companies."

Northern Small Cap Value

At Northern Small Cap Value Fund (NOSGX), manager Robert Bergson sticks closely to the Russell 2000 Value Index's sector allocations. He has freedom to delve outside that benchmark, but doesn't wander into midcap stocks or non-U.S. companies.

Bergson's quantitative-driven stock-picking strategy mirrors the Royce fund's requirement that firms keep strong balance sheets. Northern Small Cap Value has lost significantly less than its competitors in market corrections by avoiding unprofitable businesses and spreading its assets across 400-600 different names.

Bergson keeps a close eye on how much excess return his portfolio generates from buying stocks not included in the index. The fund also will assign its own weighting to the stocks in its benchmark.

"Our longer-term performance has been dictated to a large extent by our managing this sort of tradeoff between risk and reward," Bergson said.

With an expense ratio of 1%, Northern Small Cap Value is much lighter on shareholders' pockets than the average small-cap value fund, which charges 1.51% a year. In the past five years, the fund's annualized gain of more than 16% tops 84% of its small-cap value peers.

"It's important to us not to drift in style or market-cap size," Bergson said. "If our participants are expecting small-cap value results, we don't want to surprise them at some point."

As of 12/31/06, the Northern Small Cap Value Fund returned **20.28%** for the 1-yr. period; **16.16%** for the 5-yr. period; **12.76%** for the 10-yr. period; **12.85%** since inception (inception date 04/01/1994). Performance quoted represents past performance and does not guarantee future results. Investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than shown here. Performance data current to the most recent monthend is available at northernfunds.com. Investment performance reflects fee waivers in effect. In the absence of fee waivers, return and yield will be lower.

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Fairholme

Fairholme Fund (FAIRX:) takes a far-ranging approach. Morningstar dubs it a mid-cap blend fund, but Fairholme's managers don't pay much attention to market-cap size. "We don't run screens and we don't pick stocks based on a particular side of the style box," said co-manager Larry Pitkowsky. "We like to be invested alongside talented management teams and companies that are cheap in relationship to our analysis of free-cash flow."

The management team includes Bruce Berkowitz and Keith Trauner. Preserving capital and avoiding losses is a centerpiece of their investment strategy. In fact, Fairholme Fund's only year of negative returns came in 2002, when it shed 1.6%. That was still better than its average peer, which lost 16.5%.

In the past five years, the fund has bettered 94% of its competitors while averaging gains of more than 15% a year. It also charges 1% in annual fees, versus 1.44% for the typical midcap blend fund.

"We're all substantial owners in the fund," Pitkowsky said. "So we like to treat our shareholders like we like to be treated."

T. Rowe Price Growth Stock

Even though large-cap stocks have lagged in the past several years, T. Rowe Price Growth Stock Fund (PRGFX:), which invests in mostly blue-chip names, has produced impressive gains.

Longtime manager Robert Smith takes a patient, diversified approach to growth-stock investments—a strategy that has paid off in spades.

Even during the worst of the bear market, the Growth Stock portfolio scored top-quartile returns. It helped that Smith stayed away from the technology sector bubble, sticking instead to his growth-at-a-reasonable-price discipline.

He jumped back into tech in late 2002 once most of the damage had been done. Smith also bought into health-care service providers and consumer discretionary stocks while shares of selected favorites traded at what he considered to be relatively low valuations.

In the past five years, the fund's annualized 6%-plus return beats 89% of its competitors.

Besides limiting losses, Smith has stayed ahead of the pack as the market moved higher. In the past 12 months, Growth Stock Fund has gained about 14%, topping 93% of its peers. The fund assesses an annual expense ratio of 0.72%—less than half the going rate for large-growth funds.

"It has been a good market over the last three years to be a growth manager with a contrarian bent," Smith said. "We've been able to zig as the market has zagged."

Schneider Value

Schneider Value Fund (SCMLX:) invests mainly in large-cap names, although it dips into midcap territory as well.

Manager Arnie Schneider, known more for his institutional money management prowess, has been publicity shy. That's perhaps one reason why his four-year-old fund is such a well-kept secret.

Schneider takes a deep value approach to stocks. That means he looks for companies selling at substantial discounts to predetermined price targets set with the help of his research staff.

Since it tends to invest in restructuring cases, Morningstar fund analyst Karen Dolan warns the fund can lag its field when high-quality blue chips lead.

In 2005, Schneider Value Fund returned 4.4%, landing in the bottom-half of its large-cap value category. But it has rebounded in the past 12 months, gaining about 24% to beat 98% of its peers. The fund's three-year annualized 18% return puts it ahead of 99% of the pack.

And an expense ratio of 0.85% is far below the average large-cap value fund's 1.35% annual cost.

Morningstar has described Schneider Value as an undiscovered gem for patient, long-term investors. The fund requires a hefty initial investment of \$20,000. But its 1% redemption fee goes away after 90 days. "This is a stellar choice," Dolan concluded in a recent report.

Murray Coleman is a reporter for MarketWatch in San Francisco.

Five low-cost funds for 2007

Fund	Ticker	2006 Return	3-Yr. Avg Return*	Expense Ratio	Minimum Initial Investment
Schneider Value	SCMLX	23.9%	18.0%	0.85%	\$20,000
Northern Small Cap Value	NOSGX	21.4	17.2	1.0	\$2,500
Royce Value Plus Service	RYVPX	20.2	20.9	1.42	\$2,000
Fairholme	FAIRX	16.9	19.1	1.0	\$2,500
T. Rowe Price Growth Stock	PRGFX	14.4	10.9	0.72	\$2,500

Data: Morningstar Inc. and company report

* Returns as of 12/28/06

As of 12/31/06, the Fund was ranked by Morningstar (based on Total Return) among the small-cap value category. The Fund ranked 55/387 for the 1-Yr. period; 27/304 for the 3-Yr. period; 32/220 for the 5-Yr. period, and 27/71 for the 10-Yr. period. Morningstar ranks a fund amongst its peers based on total return with a 1 as the highest or most favorable. Past performance is no guarantee of future results. Small company stocks are generally riskier than large company stocks due to greater volatility and less liquidity. Call a Northern Trust Relationship Manager or 800/595-9111 for more complete information, including a prospectus. Before investing, you should carefully read the prospectus and consider investment objectives, risks, charges, and expenses of Northern Funds. The prospectus contains this and other information about the funds. Northern Funds are distributed by Northern Funds Distributors, LLC, not affiliated with Northern Trust.

