

Pragmatism Rewarded By John Bishop

With US interest rates expected to remain low and the economy slowly on the mend, it's a good time to return to equities. This fund's conservative approach to picking blue-chip names makes it suitable for investors who want growth and income without taking on high levels of risk.

It's long been accepted wisdom that investors should buy what they know. But sticking to the basics can be deceptively difficult in a new world of exotic and alluring investment opportunities. **California Investment Equity Income** (EQTIX), a relative newcomer to The Rukeyser 100, is a prime example of the power of keeping it simple. The large-cap value fund invests in companies whose goods and services can be found on virtually any street or grocery aisle in the US.

The fund's portfolio manager Stephen Rogers employs a multi-tiered approach to stock selection. He begins with a broad perspective, examining economic sectors and industries that he believes sport the best potential for growth. He then searches for equities that meet his requirements on a number of metrics. Chief among his concerns is a company's ability to generate cash flow.

Once he's identified profitable companies in growing industries, the real work begins. He judges companies on factors behind the numbers—the strength of their management, the quality of their products, what these firms are doing to maintain or grow their market position. Throughout this process, Rogers favors dividend-paying blue chips that produce goods or services that are consistent over time.

"We're a conservative shop. Our portfolio is never going to outperform its benchmark by 40 percent," Rogers said.

Instead Rogers aims to outperform the S&P 500 marginally but on a consistent basis. He keeps the fund's turnover relatively low, about 76 percent, to keep trading fees from eating into shareholder returns. The portfolio rarely has an exposure of over 4 percent to any individual holding. Not only does his investment

approach reduce volatility, these marginal gains accrue over time.

The fund has made short work of its benchmark during the past 12 months, returning 16.55 percent compared to a 2.79 percent gain posted by the S&P 500. The longer-term comparisons are even more favorable; for the trailing three-year period ending Nov. 30, 2010, California Investment Equity Income has beat the S&P 500 by 9.12 percent. This performance has put the fund in the top 4 percent of its category.

Top-10 holdings Chevron Corp (NYSE: CVX) and ExxonMobil Corp (NYSE: XOM) are indicative of management's strategy of choosing rock-solid companies whose products remain consistent. While the price of oil may be subject to short-term fluctuations, the commodity will only grow more valuable as global reserves dwindle.

Banking giants Goldman Sachs (NYSE: GS) and JPMorgan Chase (NYSE: JPM) also have a home in the fund's top-10 holdings. These financial titans provide mission-critical services for the global economy and boast some of the strongest brands and management teams in the industry. They also possess the implicit support of the US government.

"The financial services industry has a tremendous amount of political and fiscal support," Rogers said. "These firms aren't backed by the federal government precisely, but in many respects political and fiscal policy is designed around their health."

These firms are also primed to take advantage of what could be a massive wave of mergers and acquisitions (M&A) activity this year. American corporations are sitting on a whopping \$1.93 trillion in cash, according to recent Federal Reserve

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Sales Fee: none **Assets:** \$160.5 million
Early Withdrawal: 1%; if less than seven days
No. of Holdings: 164
Turnover Rate: 76% **Expense Ratio:** 0.99%
Assets in Top 10 Holdings: 19.9%
Min. Initial Investment: \$1,000
Largest Quarterly Loss*: -20%; 4th Qtr. 2008
Largest Quarterly Gain*: 18.6%; 2nd Qtr. 2009
Top Five Positions: Chevron Corp (CVX), Caterpillar (CAT), Coca-Cola (KO), Goldman Sachs (GS), JPMorgan Chase (JPM)

*Past three years. **Source:** Morningstar

data. These corporations will most likely deploy these funds by paying out dividends or by acquiring other firms. Should M&A activity pick up in 2011, the likes of Goldman Sachs and JPMorgan Chase will find themselves in the catbird seat.

While Rogers has reduced his exposure to the consumer discretionary segment, he isn't bearish on the US consumer. In fact, some segments have remained resilient through the crisis. Consumers have continued to support lower-tier restaurants and premium fast food chains; Starbucks (NSDQ: SBUX) has even been able to raise prices. Although Rogers has scaled back his holdings in the consumer discretionary space, he's done so in order to take profits off the table—not because of flagging confidence in the segment.

Restaurant chain Chipotle Mexican Grill (NYSE: CMG), the fund's largest holding in early 2010, sports a business model that was the envy of the industry. But when Chipotle's valuation no longer fit the fund's investment mandate, Rogers sold the entire position in the stock and booked a tidy profit.

This no-nonsense pragmatism is the bedrock of the fund's success. It also means the fund can miss out on some opportunities—Chipotle's stock, for example, booked further gains after it was sold.

But conservative investors who prefer consistent base hits instead of the occasional home run may consider adding California Investment Equity Income to their portfolios. ▲