The Worldly Goods

Not all the stocks and all the markets in the world are created equal, yet they get the equal treatment at Delaware International's value shop in London. Rigidly following a time-proven investment discipline, Emma Lewis and her International Value Equity teammates dissect the world's businesses looking for solid cash flows sold on the cheap side.

Q: What was the history of Delaware's international operation?

A: We were founded in 1990 by a group of English managers as a subsidiary of Delaware investments. Even then it was quite an experienced team of investment management professionals. They have been working together for quite a few years. Most of the original team is still with us and we now have a highly experienced investment team of 38 investment professionals that has worked together for many years under a common investment philosophy.

Since then, our total assets under management here in London have reached more than $17 billion. Of that $17 billion, about $14 billion is in equities, of which about $11 billion is in the Europe-Asia-Far-East (EAFE) mandate, whether it is retail or institutional. The International Value Equity Fund has also grown significantly over the past year or so.

Q: So, your track record as a fund is more than 10 years. What is your strategy now and has it changed somehow over time?

A: We are a value-oriented manager and we use a rigorous dividend discount model (DDM). That is what we are using in order to look for value in both stocks and markets. The beauty of that is that we don't look only at the initial dividend yield, but also at the future real growth of the dividend as well for many years to come. We are long-term investors, we not only invest in companies for a long time, but we also analyze companies for a long period of time.

The key benefit of that approach is that it is aimed at providing a rate of return which is meaningfully higher than inflation. So we are not just looking for relative returns, we are looking for absolute returns as well, and that is because the real growth of dividends takes inflation into account. Some people consider it old-fashioned to look at inflation, perhaps, but history has proved it is always worth including in calculations of value.

Q: And you also apply the DDM to companies that aren't consistent in their earnings or dividend growth?

A: Yes. Consistency is not necessarily important. It would make the analyst's life easier in terms of making assumptions for earnings and dividends, but the lack of consistency would not necessarily preclude a company from being included in the fund. We are looking for value and if the value is there, it won't matter so much if the money comes today or in three years, as long as the value in terms of present-day value is there. For every company we invest in, we make this very long-term forecast.

Q: What about the qualitative analysis of what a company really is?

A: First, I would run the screens and I would find companies that look attractive on an initial screen. Then I would add a "rough and dirty valuation." I will quickly calculate the approximate value of that company using the DDM. And then, if I think that it is worth spending the time, I can take anywhere

Delaware Intl Value Equity A		
Fund Facts		
Symbol	DEGIX	
Website	www.delawarefunds.com	
Address	Delaware Management Company, One Commerce Square, 2005 Market Street, Philadelphia, PA 19103-3682	
Tel. No.	800-523-1918	
Inception	10/31/91	
Portfolio		
Total Net Assets *		$196
Avg Mkt Cap ($ Weighted) *		---
Average Price/Earnings Ratio		---
Average Price/Book Ratio		---
Turnover Ratio		23%
Investment Information		
New Investment		Open
Min Initial Investment		$1,000
Min Subsequent Investment		$100
Min Initial IRA Investment		$250
Risk (Against MSCI EAFE IX ID - 3 Years)		
Alpha		0.6969
Beta		0.9455
R-Squared		0.9236
Returns vs. Lipper International Fd Index		
	DEGIX	**Index**
1 Year (Cum.)	26.87%	23.26%
3 Year (Ann.)	2.45%	-2.80%
5 Year (Ann.)	2.91%	1.29%
Returns vs. MSCI EAFE IX ID		
	DEGIX	**Index**
1 Year (Cum.)	26.87%	21.23%
3 Year (Ann.)	2.45%	-6.07%
5 Year (Ann.)	2.91%	-2.44%
Fees and Expenses		
Max Sales Charge - Front		5.75%
Max Sales Charge - Deferred		0.00%
Max Redemption Fee		0.00%
Total Expense Ratio		2.13%
Portfolio Manager		
Management Team		---

** millions* *Data through: 11/30/03*

Source: Company Documents; Lipper

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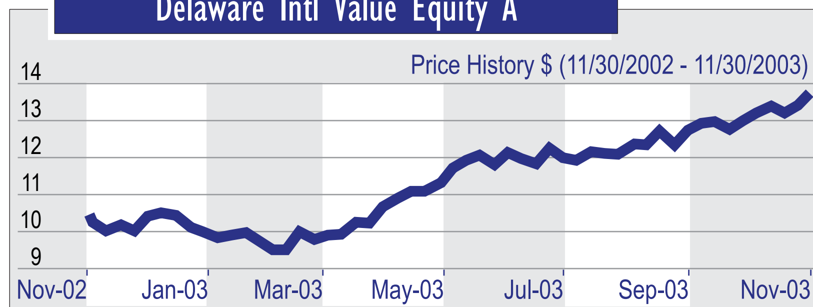

between one week and three months to really assess this company. Every analyst in this company uses the same analytical tools. We do the same DDM. You are not allowed to look at a company using any other analytical tool. As a result you get absolute consistency across the board. This way I can validly compare the valuation for a Japanese pharmaceutical company with that of a German automaker, or a U.K. retailer.

Q: But how do you get your data? The data obviously still comes from different sources.

A: We do our own fundamental research and the starting point is talking to the company. Usually, you have some experience either within the sector or you know someone who does, and this is your starting point, actually, but then you need to talk to the company. I have to go to Asia at least once a year if not twice a year and I have to visit all the companies or at least meet with management of all the companies that I invested in.

It is a very rigorous process. Each analyst has to present their assessment of a company to their peer group, which would be the Pacific team for me or the European team for a European analyst. Then you also have to present that work to the equity strategy committee, which is made of the four most senior members of the equity team. And until you have really proven yourself to really know and understand that company, the work you have done would not be passed and that company would not be able to go into the core list. It can't get into the fund's portfolio until the analyst clears all these hurdles.

You can really push it very fast. There is no set program, and if the company is really offering value, you can be surprised at how quickly you can get it through these committees. If we can get a good company into our clients' portfolios, we can move very quickly. That is what we are paid to do. But equally, because we have very focused portfolio - the fund has 52 stocks and yet we have 39 investment professionals - you can imagine that actually we are not looking at that many stocks individually. Each of us probably has responsibilities for no more than ten stocks at most. So, we can really get to know those stocks.

Q: How do you define international?

A: For this particular fund, the vast majority of our assets are benchmarked against MSCI EAFE - that is Europe, Australasia, and the Far East. So, it is all the developed world that does not include the U.S. We have small exposure to the "soft end" of emerging markets - a little bit in South Africa and a little bit in Korea - about 1.5% in each. We have a fantastic emerging-markets fund, but I would not want to have exposure to the "hard" emerging markets like Russia or China in this fund. That is not what my clients pay me to do. My clients pay me to run an international fund. I don't make that decision, and I believe I should not make that decision for them, because I don't know what their risk profile is. I have to offer them something pure and then their advisor can make the necessary asset allocation decisions based on an individual client's risk and reward profile.

Q: You mentioned that there was a great deal of interest towards international portfolios, but these past three years, the developed markets from U.S. to Europe, to Japan, have moved more or less in sync. Is there still a case for international diversification?

A: This is a question I am often asked. And yes, absolutely, in the past few years there was a much higher correlation. There were a number of reasons for that correlation. Partly, it was the tech and telecom boom and bust. We expect over the next few years that correlation to start to break down. My reasons for encouraging people to invest internationally, however, are not only to diversify, although it is important. We run the dividend discount model for all the different markets, and almost without exception, most markets offer much better value than the U.S.

Q: Where do you see your main advantages to the U.S.-based international money managers?

A: Many people consider London to be the center of the international fund management community - we are well positioned in terms of time zones, and well positioned for traveling out to all those different markets. We have an advantage particularly for Asia compared to America, because Asia is, of course, not so far away for us.

We also have a huge amount of experience in the different markets. When you meet the analysts, you can just see that the depth of their international experience is quite high, both in terms of experience with the countries and, of course, actually working within international investments. Experience helps a lot. I think members of our team have about 13 years of investment experience on the average.

Q: How do you do the ongoing assessment of companies?

A: Once a company is approved to go into the client portfolios, then we have to assess that company every year. Sometimes we do it more often, depending on whether there have been large changes. But we also have to report on all the companies that we hold at least every two weeks at Pacific meetings or European meetings, depending on which team you are in. So, you have your peer group meetings and you run through all the stocks in your market and you have to report on what has happened for the last couple of weeks and why. For instance, if the price of a stock you have held has reduced and you believe that it was an unfair reaction of the market, and the stock presents an exceptional value, you would accumulate.

Q: Then when do you sell?

A: There are three reasons to sell a stock. The first is price appreciation. Of course, as an analyst, that is the reason you would always want to sell. With the DDM you know exactly what a stock should be worth.

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We are quite strict on this, because analysts do get to like their stocks a lot. When you hold a stock for five years, you get so close to it, you know the management, and you don't want to let it go. I do like a successful sell, when it happens, because I feel that I've really drawn that chapter to a successful close and I know that I have made my clients a good return.

"My reasons for encouraging people to invest internationally are twofold. Firstly, as many are aware, ***international investing allows an investor to diversify****. Secondly, almost without exception,* ***most foreign markets offer much better value than the U.S."***

The other reason to sell is if there is a significant change in the fundamentals that are assessed when calculating the present-day value. Let's take the airlines, for example. When SARS came out at the beginning of February this year, obviously no analyst had factored in an epidemic in their assumptions of the value of that company. But as soon as that happens, what you do is you go through your assessment and you make changes on the revenue level, and the profit and loss, and you see what happens to earnings, what happens to the cash flow, what is likely to happen to the dividend stream during this period going forward. Then, your theoretical stock that was worth $10 yesterday may now be worth $5. If that is the case, and that stock is actually priced at $7.50, certainly it has gone from being very attractive to being very unattractive. So, you would sell.

Another example would be the Asian crisis back in 1997 and 1998. Then you saw currencies depreciating very fast and some Asian companies had U.S.-denominated debt. The value of their debt was increasing as their currencies depreciated. Consequently, we had to make changes to our assumptions and yes, in some cases you had to say that a stock wasn't worth what it used to be and you had to sell. No one gets it right every time, but this strict discipline forces us to face up to mistakes quickly.

The third reason to sell it would be a more attractive alternative. Let's say we hold three stocks in Singapore at about the right level, and I don't want to hold any more. But suddenly a fourth stock halved overnight. I know that stock, I know the management, and I know that stock should not have halved. Maybe it should have come down by 10% or 20%, but I certainly see it as a fantastic opportunity. So, I do the work on that stock and if I believe that it actually offers more value than one of my other stocks, I'd sell the other stock and buy that one instead.

Emma Lewis

Emma Lewis joined Delaware in 1995, assuming analytical responsibilities in the Pacific Basin Team. Currently, she is a senior portfolio manager at Delaware International where she manages international portfolios for institutional clients, as well as co-manages the International Value Equity mutual fund. Emma began her investment career at the Dutch bank ABN AMRO and later joined Fuji Investment Management. She is an Associate of the UK Society of Investment Professionals.

Q: *What is the breakdown of the markets in your portfolio?*

A: We have a strong overweight position in Asia, but we are actually underweight in Japan, which is to some people a bit surprising. We do not think Japan offers that much value, compared to many other markets within our universe.

We think Australia offers a very good value and we are overweight in that market. Not many people know that Australia had a productivity miracle during the 1990s. People talked about the productivity miracle in the U.S., but actually, Australia's productivity improved much more than even the U.S.'s. In Australia we hold financials, consumer stocks, and other areas, such as telecom. We have an overweight position in Hong Kong as well, because we think there are some good stocks there that offer excellent value.

Equally, we have found excellent value in Singapore and we have a couple of holdings there - a conglomerate and a bank. There is a fair amount of restructuring going on in Singapore with increased emphasis on shareholder value. Singapore is one of those countries where the infrastructure really works well. It is seamless, it is smooth, and it works. That really helps - it has a strong service culture and very stable politics. At the same time it has a huge exposure to global trade. So, every time global trade picks up, Singapore should benefit.

Q: *What would you tell a potential investor in your fund in terms of what they can expect and what they should not expect?*

A: Our intention is that this always be a value fund using the dividend discount model. As a result of that, I hope the key history-proven benefits will continue - the real rate of return, the strong downside protection with the very strong defensive characteristics, the very low volatility compared to the benchmark index and also to other international managers.

In terms of performance, I can't promise anything for the future, but in the past, we have beaten Lipper's benchmark year-to-date, and over the one year, three-year, five-year, and ten-year periods. Investors usually expect consistency and that is what we are aiming for.

Alexander Vantchev

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