TICKER'S CHOICE

The Long and Short of It

Since inception in 1997, the AXA Rosenberg Value Equity Long/Short Fund sports a three-year average annual return of 8.8%. With a 17% return as of Nov. 30, this fundamentals-based fund employs a balance of long and short positions that is backed by a expert team of researchers.

Kathryn Mohan McDonald joined AXA Rosenberg in 1999 as a senior product strategist. Aside from managing the firm's Value Long/Short Equity Fund, she also heads the Global Long/Short Equity Fund. Both funds have been ranked among the year's best 100 performers by Lipper. Previously, Ms. Mohan McDonald worked for BARRA Rogers Casey. She has a B.S. from Willamette University and an M.I.M. from Thunderbird, the American Graduate School of International Management.

Q: The overall market declined for five straight days, and yet your fund advanced for the same period. Tell me why that happened.

A: This speaks to a much longer pattern between our performance and the broad market. Basically, year-to-date, for the first three quarters you have the market going straight down and the performance of the fund basically straight up. Then early October, we have the first of a couple of big rallies that are led by stocks that have met earnings expectations — albeit expectations that have been lowered — that we had hoped they would start meeting. Now the market is looking for this earnings-led recovery. What people are starting to look for is companies to meet or exceed these lowered expectations. The companies that lead the rallies may or may not, over the long run, be the companies that are really quality companies in terms of earnings. We take a little longer time horizon, and for us, just meeting expectations might get you in the door. Frankly, we're looking for companies that are going to give the most cumulative earnings over a certain period of time per dollar of cost. Those are the companies we take long positions in. We short other companies for which the opposite is true, companies that are going to disappoint in future earnings per dollar of cost.

Q: Why did your fund's NAV decline in October and November?

A: The performance of the fund was way off, about 9%. We're very much in a transition time. The stocks that performed the best in November were the stocks that had performed the worst over the prior nine to 12 months. Frankly, we don't yet see a lot of fundamental change in those stocks, except for the fact that people think we've hit bottom and the market is going to go up, and they're pouring money into the high beta stocks that have had really depressed prices over the last 12 months. It seems that's where they think they're going to get a bigger kick because the market's rebounding.

Q: The mutual fund rating agencies

AXA Rosenberg Value Long/Short Eq Inv		
Fund Facts		
Symbol	BRMIX	
Website	www.axarosenbergfunds.com	
Address	AXA Rosenberg Funds, 237 Park Avenue, New York, NY 10017	
Tel. No.	800-447-3332	
Inception	12/18/97	
Portfolio		
Total Net Assets *		$97.40
Median Market Capitalization *		$1,300.00
Average Price/Earnings Ratio		22.35
Average Price/Book Ratio		2.28
Turnover Ratio		126.45%
Investment Information		
New Investment		Open
Min Initial Investment		$2,500
Min Subsequent Investment		$500
Min Initial IRA Investment		$2,000
Risk (Against Std Index - 3-yr Average)		
	BRMIX	**Category Avg.**
Alpha	- 2.93	1.24
Beta	- 0.65	0.49
Returns vs. Category		
	BRMIX	**Category Avg.**
1 Year	27.67%	- 7.32%
3 Year Avg.	10.36%	- 0.14%
5 Year Avg.	---	0.24%
Returns vs. S&P 500		
	BRMIX	**Index**
1 Year	27.67%	- 16.51%
3 Year Avg.	10.36%	- 0.83%
5 Year Avg.	---	0.23%
Fees and Expenses		
Max Sales Charge - Front		0.00%
Max Sales Charge - Deferred		0.00%
Redemption Fee		0.00%
Total Expense Ratio		2.48%
Portfolio Manager		
Kenneth Reid		12/18/97

** millions*

Source: Mutual Fund Company Documents

place you in various categories. What category would you prefer?

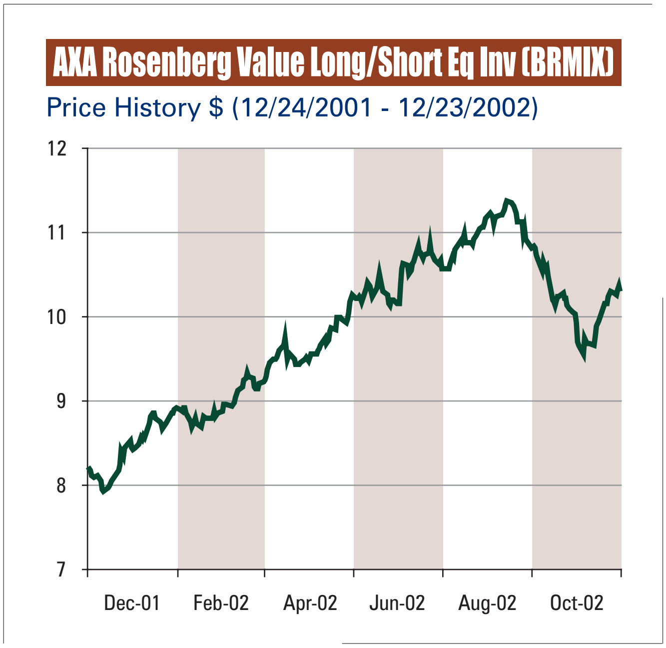
A: We regard ourselves as primarily in the alternative class. We are a long/short equity product, but we are not a directional long/short equity product, so we're not net long or net short at any given time. Our program is not technically market neutral. By that, I mean even though we're dollar-neutral and we're not net long or net short, we're not beta-neutral, so our beta is not consistently zero, over time.

Q: With hundreds of positions in the fund, how quantitative is the selection approach?

A: We regard ourselves as fundamental managers. We use a lot of quantitative techniques to refine what we do, but ultimately the inputs to our process are simply the published financials of a company, and in a very secondary way, market opinion data.

Q: In my examination of your firm's overall strategy, I was amazed to learn you have access to more than 80 data suppliers.

A: This is the quantitative part of it. We have a research center that employs about 25 people, all of them with an unbelievable amount of education. I can't remember how many Ph.D.s are over there who work with large amounts of data. We have a lot of redundancy in the data we use, because we want to be able to say, OK, if Supplier X is saying that net sales are this for IBM and Supplier Y is saying that net sales are something different, we need to reconcile the difference between the two. We absolutely want to make sure that when we put this information into the system, it is the cleanest, most precise information about companies that is available.



Q: How can you cope with such diversity, with more than 800 stocks long and 800 stocks short?

A: We start by intaking all the publicly available financial information on every stock that's listed in the U.S. above a certain threshold. We don't go into IPOs right off the bat. We don't go into stocks with a capitalization of less than $10 million. Other than that, we follow over 5,000 stocks. When we start the process, we value every stock in the domestic universe relative to its peers. We break a company into its operating businesses. We try to value each of those segments relative to similar segments at other companies. Once we have a value for each of the pieces, we conceptually add up those pieces to see what we think the fair value of that company is. Then we compare that fair value to what the current market price is. Depending on whether or not the fair value is above or below the market price, we may choose to take either a long or short position in that stock. For the stocks that we like, we take positions in about the top 15% of those names. And in the stocks we don't like, we take short positions in about 15% of that pool. When you're in the small- and mid-cap universe, you end up with 800 to 1,000 stocks.

Q: The huge number of positions implies you do a lot of trading. How do you handle this?

A: Everything we do, we do internally. I can't think of one significant aspect of our process that is handled externally other than custody and clearing. We do all the trading internally. We turn over the longs and shorts about 125% a year. The holding period averages about eight months.

Q: How do you keep the expenses in check?

A: We incur such low market impact and trading costs that we really do not eat up the alpha from the strategy by trading. We trade in a very accommodative style. The traders are given, among other things, a list of stocks that are ranked by net benefit to the portfolio. If they can't get prices they like for the first stock on the list, they skip down to the next stock. At no time are they forced to trade into or out of names in any hurried way. We take every effort not to push prices around when we trade. We trade small amounts. We get excellent treatment from the brokers we deal with. In our optimization process, we're constantly looking at this consideration of how much it will cost to trade this stock.

Q: Selling short has been described as more art than science. Are you trying to make it into science?

A: Shorting, especially in the U.S., and we do offer long/short products in Europe and Japan also, is so popular now that you can basically get borrowability in almost any name you want. When we first started long/short in 1989, we were limited to the large-cap names because that's where the liquidity was, that's where the costs weren't prohibitive. The market has become more accustomed to securities lending, and brokers became more aware of the fact that this was a really good way to make some incremental money for their businesses. Shorting is a good idea if, and only if, you have a process that leads you naturally to short candidates. More importantly, your process can't require lots of analyst coverage, because, on the short side, it's a lot harder to find Wall Street research that's good at finding really bad companies. Our process does not rely on that, because we're not beholden to Wall Street research, so we're able to short very inexpensively, and we have a model where recommendations on the short side are just a natural outcome of the way we find recommendations on the long side.

Q: In examining your fund's overall strategy, I notice you don't try to time the market, and instead rely upon temporary inefficiencies.

A: When I think of temporary, I think of three- or four-day pricing inefficiencies. These are longer term. These are companies that, over the next few years, we expect to either go up or go down to what we think their fair value is.

Q: I like this statement from the Core Beliefs section on your website (www.axarosenberg.com) from Barr Rosenberg: "We believe that markets are reasonably efficient but not perfectly efficient." Would you care to elaborate on this theme?

A: We think that there is a lot of information in prices. Prices may not perfectly reflect what is going on with a company, but, over time, investors really do have an uncanny way of rewarding companies that make them money and penalizing companies that lose money. In the short term, investors have a harder time with that. But over the long term, investors are very good about doing that. In that regard, we certainly regard the equity market as being pretty efficient. We think that we're able to uncover small inefficiencies and/or small mispricings in the market. That's part of the reason we want to hold so many positions. What we're trying to do is make a few basis points on a thousand names, rather than make 5% on 10 names.

Q: Since the fund holds so many names, the ever-present question of what you like isn't applicable.

A: It's frankly a source of frustration sometimes when we're talking to people. We're often asked to present at conferences and seminars. You have a different type of long/short manager that can get up and say, "I am long 10% IBM, and let me tell you why." What we're focused on is the portfolio characteristics of the whole basket of longs relative to the characteristics of the whole basket of shorts. We can tell you lots of stories about the characteristics, but frankly, that's pretty boring dinnertime conversation.

Q: What are the characteristics of your long and short candidates?

A: Ultimately, we're trying to build long positions that go on to offer more future earnings per dollar of today's cost than our shorts do. We think that that is going to be the driver of return over the long run. There's a great deal of evidence to suggest if you can pick companies that do go on to provide superior earnings yield, which is essentially what it is, then you will make money. Then the question becomes, can you do that or not? When we sat down this time last year and built a portfolio, we predicted that the longs are going to generate more earnings per dollar of cost than the shorts. Today, we look backward and ask ourselves, "Did indeed the longs produce more earnings over the shorts over the last year?" And, invariably, we find that is the case. It also makes a lot of good economic common sense. As an investor, you want to try to maximize your exposure to those future earnings vs. what you're paying to get into it.

Q: Did your long positions drive your positive performance relative to the short positions?

A: We got it from both sides. When we look at the detailed breakdown of which side returned what, there were definitely a couple of months in which the shorts were driving things and periods in which the longs were driving things. Over the long run, we're really equally skilled at picking longs and shorts, and so we wouldn't expect that for short periods of time you may see the return completely dominated by the short side picks. Since the inception going back to 1995 we see that both sides are contributing pretty equally and are really independent of moves in the broad market.

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>
> **Kathryn Mohan McDonald**

Q: How has the recent performance affected the flow of money into your fund?

A: You know, frankly, that (performance) is always going to be part of the mutual fund world. There's no getting away from that. As much as we like that money, that's definitely hot money because it comes to us during good performance and when things get dicey, people yank it away. The money that we've also seen, though, has been around for a while, people gradually increasing their position size with us. We have a core group of investors, both on the mutual fund side and then, frankly, most of the money that we manage long/short is for institutional clients in separate accounts. From that group there's definitely been increased interest. We've seen inflows of assets that we think are going to be sticking around for a while, and that is what we're happy about. ∎

Dave Jennings