

Think and Invest Globally

The high yield world does not sound that risky when you talk to Greg Hopper, the manager of the Julius Baer Global High Income Fund. Spreading out of the traditional definition of the high yield category, the fund achieves diversification through investing in allied asset classes as long as they are senior to equity. A key feature of its strategy is the global approach and the equity-like analysis of the high-yield bond segment.

Q: What's the investment philosophy of the fund?

A: The core of our philosophy is taking a global approach to the high-yield market. We achieve diversification by investing in a series of 'allied high-yield classes.' These classes are not well correlated with each other, but they are all senior to equity and provide high total return primarily through yield.

Those allied asset classes can come from diversifying into Europe, Asia, sovereign and corporate emerging market bonds, both local and hard currency denominated. We can also go out of the high-yield category as strictly defined by the indexes and into things like convertibles, crossover credits, or high-yield munis, although we haven't actually bought any high yield munis yet.

But none of these asset classes is going to dominate our portfolio. We are not going to be a convertible bond or emerging market fund in disguise. The majority of the portfolio, or about 60%, is still comprised of good old-fashioned US high-yield bonds. The balance, however, is invested in some of the "allied" high yield asset classes I just mentioned. In this manner, we believe we can seek far better diversification than by pursuing the usual approach, which is simply to invest in hundreds of issues in the conventional U.S. high yield market, most of which, at the end of the day, are highly correlated with each other.

Our relatively smaller size fits this approach well. Many high yield managers are overseeing portfolios that can add up to over 10 billion dollars. For a relatively small market where the average issue size is something like 300 million dollars, 10 billion is a lot of money. At those sizes, they are forced into a strategy of diversification through issue proliferation. We, on the other hand, can be choosier and can move around and between some of these asset classes I am discussing. We are trying to take advantage of the fact that we are smaller, more nimble, and we don't need to burden ourselves with hundreds of issues. That enables us to manage more easily the inevitable liquidity difficulty of this market.

Q: How that philosophy translates into an investment strategy and process?

A: The best way to describe our investment process is through what we call our five hallmarks. First of all, we think and invest globally. For example, when we look at a paper company, say Bowater Inc, we're not just looking at the U.S. paper industry but at the global paper industry. We would compare buying Bowater to buying Carter Holt Harvey, which is a New Zealand paper company, or to buying Bowater debt in Canadian dollars.

The second hallmark is the credit analysis, which is crucial in high yield management. When we do our credit analysis, we take an equity approach. We don't just calculate credit ratios which



GREG HOPPER serves as Portfolio Manager of the Julius Baer Global High Income Fund.

He received a BA in economics from Beloit College, Beloit, Wisconsin in 1980. Greg Hopper began his career at Fleet National Bank, working his way from 1980 through 1983 to a position as International Lending Officer covering the Middle East and Africa. After earning an MBA from Columbia University in 1985, he worked with Drexel Burnham Lambert from 1985 through 1989 before leaving to join PaineWebber's Mitchell Hutchins Asset Management. For most of the 1990's Mr. Hopper worked as a Senior Portfolio Manager at Bankers Trust. He left Bankers Trust after its acquisition by Deutsche Bank to continue managing high yield bonds first at Harris Investment Management, where he inaugurated the firm's high yield product, and then at Zurich Scudder Investments, where he was responsible for all institutional high yield bond portfolios. In 2002, following Deutsche Bank's acquisition of Zurich Scudder, Mr Hopper joined Julius Baer to launch the firm's current set of high yield products.

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are interesting, but that’s not analysis in my mind. That’s ratio crunching. We want to know what the nature of the business is, what the shape of the industry is, how these companies are positioned in the industry, etc.

The third hallmark of our investment process is related to risk management. We believe that you need a stop loss discipline, or as we put it, “when in doubt, get out.” It is not a black-box discipline, but it is triggered by events, by movements in the underlying equity, or by rapid and substantial movement of the bond versus the peer group. When we see any of those events, we ask ourselves why we should own this bond, while most managers would ask themselves if they should sell it. We flip that question and put the burden of proof on those who might want to keep the bond.

The fourth hallmark is that we don’t want to overly diversify the portfolio. We want to be masters of some credits not dabblers in hundreds and hundreds of credits. We want to make a difference with our credit research and to take advantage of our relative size to be able to move in and out quickly.

And the fifth hallmark is that we’re not big traders. We want to be investors and we don’t flip bonds. We sell if the bond hits one of the stop-loss triggers, which is a relatively rare occasion, or if we find a security with higher enough risk-return promise to pay for the transaction cost.

Q: What is your definition of ‘global’? Is it primarily the U.S., Japan, and Western Europe?

A: The U.S. market historically has hovered around 60% in the portfolio. The

second largest component is probably Europe, which has hovered between 15% and 20% in the portfolio. The remaining 25% to 20% have historically been divided among sovereign emerging market bonds, corporate emerging market bonds, and local currency denominated bonds.

Q: In terms of your research process, how do you analyze sovereign risk and macro economic situations?

A: We rely to a considerable degree on the internal resources of Julius Baer, both in New York and in Europe. It’s really been the strength of the firm. We have a long history in Eastern markets as well as many local contacts, and we rely a lot on these insights. We have a number of economic strategists who help to interpret the data and we listen to outside people as well.

The parameters we look at include budget deficits as a percentage of GDP, inflation trends, GDP growth, external debt as a percentage of GDP on a trend basis. But this is data everybody has access to; the most important part is interpreting the data. We rely on people within the firm with long histories on these markets to do that.

Q: Can you give us some examples of specific investments that illustrate your process? How did you generate the idea and how did you end up adding it to the portfolio?

A: A good illustration of our process is TRW, probably one of the highest quality auto suppliers in the high yield market. We no longer own it but several years ago, they issued a series of bonds denominated in dollars and euros. We liked the TRW credit, especially within the auto sector, which has been a troubled sector in the last few years. It has more diversified sales than many of the other issuers plus a leading market position in each of its segments. TRW is especially well positioned to benefit from the growth of safety equipment and airbags.

The bonds, unfortunately, were well-discovered and well-bid and did not offer particularly great value – either in dollars or euros. But there was a subsidiary called Lucas Verity, which had

its own history in yield market before it was bought by TRW. At one point, before Lukas Verity was part of TRW, they issued a 30-year sterling denominated bond. Many high-yield managers didn’t want anything to do with it for a number of reasons, mostly because sterling denominated bonds are avoided by a lot of people. But we care about the bonds first and we worry about the currency later. We might hedge that back or not, so that was not a disincentive to us.

The other problem for many high yield buyers was the 30-year maturity of these bonds because a lot of high yield buyers don’t go beyond 10 years. I find that quite absurd because the vast majority of high yield issuers are called, tendered, swapped out, or default within the first 5 years of their existence regardless of the original duration. I believe that anyone, who applies to high yield the parameters of an investment grade buyer, who quite rightly is more concerned about the effects of interest rate changes on the value of longer maturity bonds, is missing the point. So the fact that it was a 30-year bond was not an impediment to us.

The third obstacle to high-yield managers was the high dollar price of the bond. However, the reason for the high dollar price was the high coupon and because it was not callable. But that’s actually beneficial, since you’re not giving the company the option to take the upside away from you. And there was upside. Given the cash flow, there was a good chance that the company would do something about these bonds. That’s not why we bought them but that was an extra reason. Eventually, the company did tender for the bonds and the return, relative to the standard generic TRW bond that all our peers love to chase, was substantial.

Inside the U.S. we’ve been invested for quite a while in a company called OM Group, a processor primarily of nickel and cobalt chemicals. The company ran into a number of problems a couple of years ago when it built up too much cobalt inventory before the price, collapsed. The management was completely replaced and the metals trading operation was sold to a German com-

pany. OM just kept the high-demand business that processes nickel and materials for batteries and all the micro electronics. Basically, they became a specialty chemical company. We saw that their strategy was going to be quite beneficial, given what was going on with their end markets. The market was very skeptical because of the history of trading at very high yields but that has gone away.

Q: Would you explain your portfolio construction process in terms of number of holdings, benchmarks, turnover, etc.?

A: We run between 80 and 100 issues, which provides adequate diversification for the portfolio, especially since we draw our securities from a number of different high yield markets that are not correlated with each other. That approach allows us to concentrate and really know the issues in the portfolio rather than spread ourselves across 500 different issues. The turnover has moved steadily downward since we first set up the portfolio. It's quite competitive with our peers and moving downward.

We benchmark ourselves against Merrill Lynch Global High Yield Constrained Index. As many index providers, Merrill Lynch created constrained indexes after the whole Enron debacle, when huge fallen angels represented 10% or more of the market. Through these constrained indexes they limited the percentage that any single issuer could comprise. We use the global version of that constrained index, which basically reflects 88% of U.S. high yield and 12% of non-US high yield, mostly European.

Q: What do you think that high-yield investors should be mostly aware of? Is it the credit analysis, the market characteristics such as liquidity, or something else?

A: First of all, I think that the high yield market is still an esoteric market where it's difficult to get information on some of the companies. An event can happen that can move the prices quite abruptly. That is why it is extremely important, more than in many other asset classes, to invest through a mutual fund. It also can be very expensive if you invest directly, since bid-offered


spreads on bonds for the retail investor can be quite heavy. So it's a market that you need to navigate through mutual funds, and the mutual fund should be able to maneuver through the occasional difficulties of the high yield market. The nature of the high yield market puts a premium on flexibility and liquidity, which is something that we pay attention to both in terms of the size of the fund and the securities we buy. We try to have a portfolio that we could move out of fairly quickly at a reasonable price. Being diversified across a number of different high yield asset classes helps in that process and being relatively smaller helps.

We do believe there is value to investing a portion of the portfolio in relatively smaller names, but you need to have a substantial portion of the portfolio invested in names that have real liquidity. Some of the names with the best liquidity are companies that are non-US issuers, such as Norilsk Nickel, for example, a Russian nickel company or some Brazilian issuers. Although the non-US issuers can be volatile, they are larger than many U.S. issues. You can trade these bonds, especially if you're not a huge high yield fund, which we're not.

Q: How large is the U.S. high yield market?

A: It is about \$600 billion in market cap with about 1,800 existing issuers, most of which don't trade by the way, so it is not such a liquid market. By expanding into the allied high yield markets, we end up addressing a \$2.2 trillion market with about 5,000 issues.

Q: What kind of risks do you perceive and how do you mitigate them?

A: I think that the general public perceives more risk in high yield than is actually there. Let's not forget that high yield is senior to equity. If you worry about a recession, you'd better worry about your equities first because the high-yield bonds will not be as volatile as the equity. We have an independent risk management group that is measuring our tracking errors and our concentration levels, and they alert us when they see problems. But that's really done independently. 

Julius Baer Global High Income Fund*

Symbol	BJBHX (Class A), JHYIX (Class I)
Website	www.us-funds.juliusbaer.com
Address	Julius Baer Inv. Management LLC, 330 Madison Avenue, New York, NY 10017
Tel. No.	800-387-6977
Inception	Class A: 12/17/02; Class I: 1/30/03

PORTFOLIO	
Total Net Assets (Class A)**	\$43.59
Total Net Assets (Class I)**	\$29.25
Turnover Ratio	N/A

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment (Class A)	\$1,000
Min Initial Investment (Class I)	\$1,000,000
Min Subsequent Investment (Class A)	\$1,000
Min Subsequent Investment (Class I)	\$0
Min Initial IRA Investment	\$100

RISK (BJBHX AGAINST MERRILL LYNCH GLOBAL HIGH YIELD CONSTRAINED INDEX - 3 YEARS)	
Alpha	-0.11
Beta	1.08
R-Squared	92.51
Ann Std Deviation	4.73
Sharpe Ratio	1.51

RETURNS VS. MERRILL LYNCH GL HIGH YIELD CONSTR IX			
	BJBHX	JHYIX	Index
1 Year (Cum.)	6.93%	7.20%	3.58%
3 Year (Ann.)	9.80%	10.08%	4.76%
Incep. 3/1/99	12.59%	13.04%	6.55%

FEES AND EXPENSES	
Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee**	0.00%
Total Expense Ratio (Class A)***	1.25%
Total Expense Ratio (Class I)***	1.00%

PORTFOLIO MANAGER	
Greg Hopper	12/17/02

* Effective September 15, 2006, the Julius Baer Global High Yield Bond Fund changed its name to the Julius Baer Global High Income Fund.

millions *as of 10/31/05

The Investment Advisor has contractually agreed to reimburse certain expenses of the Fund through 2/28/07, so that the net operating expenses of the Fund, based on average net assets, are limited to 1.00% and 0.75% for Class A and Class I, respectively.

As of 9/30/06 Source: Company Documents, Morningstar

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