

## Macro Trends, Macro Gains

*Global investing with all its inherent sector, country-specific and currency risks requires broader perspective and a disciplined approach. Sentinel International Equity Fund manager Kate Schapiro and her team follow a unique strategy that tracks country, global, sector and even style trends, to pick stocks that will provide above average returns over the long term with a moderate level of volatility.*

### **Q: What is your investment philosophy?**

**A:** Our philosophy emphasizes the key elements of investing: quality, earnings growth and valuation. We believe that if we invest in high quality companies whose earnings are growing at an above-average rate, and buy them at a reasonable valuation, then over time these investments are likely to outperform the market and peer group.

We manage a core international large-cap fund that draws ideas from our investment universe of around 4,000 companies. We track secular trends in a multi-dimensional fashion, whether adopting a local perspective or a more distant, objective view. We always maintain a global framework, which enables us to measure investing in one country or sector versus another.

### **Q: Why do you focus on company's earnings growth over other growth categories?**

**A:** We do look at other growth measures such as revenues, cash flows and dividends but we focus primarily on earnings growth because that provides a way for the price to appreciate over time. We are GARP-style investors – growth at a reasonable price - hence if we are buying stocks at reasonable or relatively attractive valuations compared to the market or peer group, then we can earn returns from the company's profit growth as well as the potential for valuation expansion. We are not overly restricted by valuation metrics and we can sometimes pay a little more when that makes sense.

### **Q: What is your investment strategy?**

**A:** We aim to manage a fund that will outperform the international equity benchmark over time, in

our case the Morgan Stanley Capital International Europe Australia Far East Index ("MSCI EAFE Index"), and to do so with a moderate level of volatility, thus providing above average returns with moderate risk. We want to capture a lot of the upside in the market, but to also protect the downside. Therefore, our fund generally does relatively well in difficult markets.

We have divided the process for the international equity fund into four parts. They are: one, identification of major themes or trends; two, financial analysis; three, corporate assessment; and four, portfolio risk management. Although we are bottom-up stock selectors, we believe the identification of trends provides a needed structure or context in which to select stocks because one cannot pick stocks in a vacuum.

The second and third parts of the process have to do with stock selection which has partly quantitative and partly qualitative factors. We look at five key factors which we believe ultimately move stock prices. On the quantitative side we assess key financial ratios identifying growth and valuation elements; and on the qualitative side we assess corporate issues such as management strategies, industry risks and sentiment for the company's stock or products.

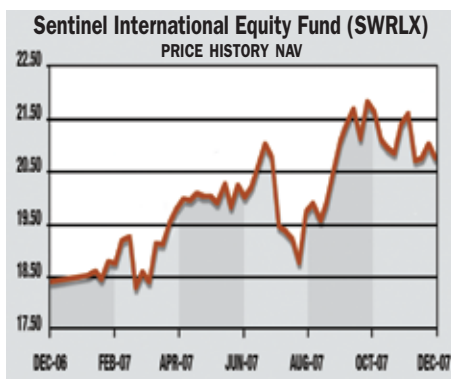
In the quantitative part of the stock selection process, which is more bottom up, we screen our universe of around 4,000 companies for companies that are \$5 billion market cap and above to maintain the fund's large cap profile. We buy only a limited number of small caps. Screens are based on the growth factors like earnings, revenue or dividend growth, as well as valuation



**KATE SCHAPIRO** joined Sentinel Asset Management in December 2005, locating in their San Francisco office. She has over 25 years of global investment experience as an analyst and portfolio manager, and she has managed international equity mutual funds, and institutional and private client separate accounts from offices in San Francisco, CA and London, England.

Before joining Sentinel, Schapiro was a portfolio manager for Strong Capital Management. And previous to Strong, she was Managing Director for Wells Capital Management.

Schapiro is a CFA charter holder and a past president of the CFA Society of San Francisco. She is a graduate of Stanford University with a BA in Spanish Literature.



factors using consensus estimates as a starting point.

Because we look at relative valuation, our hurdle rate may move up or down with the market. We can also tilt our screens to look for faster growth even if at a bit of a premium to the market. Or we can tilt towards value in which case we may be looking specifically for stocks selling at discounts to the market. These screens ultimately get us to 350 to 400 stocks that we research more closely. That's when the other three more qualitative factors, management, risk and sentiment, come into play.

So the key elements to our investment process are trend identification, stock selection made up of financial analysis on the quantitative side and corporate assessment on the qualitative side, and finally, portfolio risk management.

**Q: How is your research process organized?**

**A:** Our dedicated team of three people focuses its energy to identify good stock ideas, mainly through trends or themes identification, and that is what sets the framework for the fund.

Trend identification involves looking for major trends in the world's stock markets. They could be country or sector specific, global in nature,

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or even style trends. We think these trends are going to affect stock prices and that if we emphasize one area or de-emphasize another, it will set us apart from our peer group.

For example, we have identified infrastructure development as an important long-term global trend. Over the last few decades, developed countries in Europe and the US have been underinvesting in infrastructure like roads, bridges, airports and also bricks and mortar like plant and heavy equipment. We therefore believe infrastructure-related stocks are going to grow consistently for several years, and thus can provide strong returns. If we include infrastructure needs of emerging market countries like China, Brazil and India into this picture, then infrastructure could be a decade or even two decade-long trend.

Germany is a prime example of a country trend we chose to emphasize. In early 2006, we felt that Germany was finally emerging from a difficult decade marked by heavy costs of reunification, the introduction of the euro currency and recession in the early part of this decade. German companies had significantly improved their balance sheets in the last two years and were beginning to focus on improving productivity, growing earnings and increasing returns. Germany was slowly shedding its image of being a country with a lackluster stock market relative to its GDP size. This was an environment in which German companies could really outperform.

Consequently, we focused on finding good German companies that had gone through major changes, like utility company RWE, machinery company MAN, and banks such as Commerzbank and Deutsche Post Bank. For the last two years Germany has been one of the best performing among the developed markets, and we have had about 15% of the fund invested in Germany during this period. This year performance has been phenomenal with the DAX Index up 20% in euros and up more than 30% in dollar terms.

In the case of a sector call, in early 2007 we began looking at telecom stocks because we felt that telecom service companies in particular were going to see some growth in their earnings based on new data and multimedia services. These stocks were also looking cheap, so we overweighted the telecom sector this year with stocks like Telefonica of Spain and Vodafone in the UK.

Lastly, we believe the significant rise of China as a global economic power is a huge global trend. There are many ways to benefit from this trend. It doesn't have to be just buying Chinese companies or Hong Kong-based Chinese companies, although we do. But many companies in the region are beneficiaries of China's growth such as Uni-charm of Japan and ST Engineering of Singapore.

The next part of the research process is stock selection. We look for companies on our screens which may benefit from the trends identified. Then we assess the qualitative factors, for example focusing on the quality of a corporate management team. We meet with managements either here in San Francisco, at conferences or on-site at the companies. Although not a requirement, we've met with the management of about 80% of the fund's holdings.

Then we have the risk and sentiment factors. In this part of the process, risk refers to company specific risks that often involve product cycles, industry trends, trade and currency issues. Sentiment involves determining investors' sentiment for the stock as well as consumers' sentiment for the product or service offered. With respect to the stock, we are looking primarily at technical factors such as the flow of money in and out of the stock, or analysts' recommendations, how many analysts are upping their estimates versus downgrading their estimates, etc. This also includes hype about a new product or service offered by a company.

The final part of our process is risk management and this specifically has to do with portfolio risk management as opposed to individual stock risk.

**Q: Can you give some examples to illustrate how you select stocks based on various trends?**

**A:** Take the style trend, for example. Following the decision to bring more growth stocks into the portfolio, we identified companies with consistent earnings growth. In healthcare, we own a company called Fresenius SE, a German conglomerate, involved in kidney dialysis services, nutritional products and hospital management. It sells at a bit of a premium but it's been a consistent grower and less exposed to some of the regulatory issues that other global pharmaceutical companies are exposed to. Thus in a difficult sector, Fresenius has been a very solid stock.

Another example where we made a shift from value to growth is the case of UK-based Standard Chartered Bank vs. Royal Bank of Scotland. Standard Chartered is a faster growing bank with major operations in Asia, the Middle East and Africa. RBS, a more traditional value-style stock, had been one of our largest holdings going into the beginning of this year, but when they joined the consortium to takeover ABN Amro that was a trigger for us to reduce the position. So, we were selling something that looked cheap and buying something which had a higher price/earnings ratio, but its growth was much more assured in the current environment.

Under infrastructure plays, we own stocks like Komatsu, an earth moving machinery company based in Japan, and Siemens of Germany with its exposure to power transmission products, automation and control systems, and communications technologies. Reinvestment in power utilities is part of the infrastructure theme in developed markets, as companies have been under-investing for nearly 40 years.

**Q: How do you build your portfolio? What is your buy and sell discipline?**

**A:** When selecting stocks, we rank the five factors previously discussed with a value from one to five for each factor. We add up the factors and get a composite score for each stock under consideration. The stocks with the highest scores are selected for the portfolio, and the score also helps determine the weighting for the stocks. The stocks with the highest rankings are going to be the biggest holdings in the portfolio, usually around 2% or more. Other holdings range in size from about 1% to 1.5%. Ours is a somewhat concentrated portfolio with only around 75 stocks.

How much we weight a country or stock also depends on our primary benchmark, which is the MSCI EAFE Index. Because we run a core portfolio, with moderate volatility we can invest in some emerging markets, but we are limited to 20% maximum.

The ranking system also guides our sell discipline. If some of the factors start to deteriorate, the composite changes. For instance, if a stock has been performing well and valuation is less attractive, then the ranking for valuation comes down, and it triggers profit-taking on the stock. If there's a significant management


change at a company that results in us changing the management factor, the stock holding is also reduced. If we have a new idea with a better ranking than an old idea, we make a swap. If we're trying to reduce value and introduce more growth, we look at more value oriented names for selling, and that's part of our source of funds.

Regardless of the stock's ranking, however, positions are tempered by portfolio risk management. That is the best way for us to monitor overall portfolio volatility.

**Q: How do you manage risk?**

**A:** Portfolio risk management is an important part of our investment process. It involves two factors – one, maintaining a certain level of diversification and two, monitoring the volatility of the overall portfolio in order to maintain an acceptable level for our clients. As a core international large-cap type of fund, we are always exposed to international investment risks that may include liquidity levels, currency exchanges and foreign government regulations. Through diversification, we can help moderate those risks.

We use guidelines relative to the benchmark to determine the most we can overweight or underweight some of the major countries or sectors. Again, it forces us to remain invested in something that we may not like as much, but the risk of being out of it if we're wrong could be worse than not being in it at all. That keeps our volatility lower and also forces us to constantly review the portfolio. We do this at least on a monthly basis.

As part of our review process, we use attribution analysis, basically a BARRA model to look at relative returns across countries, regions and economic sectors. In addition, our in-house risk management technicians review the portfolio every quarter for information ratios, tracking errors, and other important metrics so we can track our performance relative to the benchmark, our peer group and our expectations. It helps identify the effects of decisions we make, and also gives an insight into the impact of not holding key benchmark stocks. Finally, we do not hedge currency exposure in the fund, but consider currency risk at the stock selection level and monitor overall currency exposures as part of our portfolio risk management process. 

## Sentinel International Equity Fund

Symbol	<b>SWRLX</b>
Website	<a href="http://www.sentinelinvestments.com">www.sentinelinvestments.com</a>
Address	Sentinel Funds One National Life Drive Montpelier, VT 05604
Tel. No.	800-282-3863
Inception	03/01/1993

**PORTFOLIO**

Total Net Assets*	\$149.7
Avg Mkt Cap (\$ Weighted)*	\$76,000
Average Price/Earnings Ratio	18.64x
Average Price/Book Ratio	3.47x
Turnover Ratio	N/A

**INVESTMENT INFORMATION**

New Investment	Open
Min Initial Investment	\$1,000
Min Subsequent Investment	\$50
Min Initial IRA Investment	\$1,000

**RISK (AGAINST MSCI EAFE ND INDEX - 3 YEARS)**

Alpha	-0.07
Beta	0.10
R-Squared	0.94
Ann. Std Deviation	9.72
Sharpe Ratio	1.14

**RETURNS VS. MSCI EAFE INDEX**

	SWRLX	Index
1 Year (Cum.)	13.18%	11.17%
3 Year (Ann.)	15.78%	16.83%
5 Year (Ann.)	19.77%	21.59%

**RETURNS VS. MSCI WORLD X-US ND INDEX**

	SWRLX	Index
1 Year (Cum.)	13.18%	12.44%
3 Year (Ann.)	15.78%	17.40%
5 Year (Ann.)	19.77%	22.12%

**FEES AND EXPENSES**

Max Sales Charge - Front**	5.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee***	2.00%
Total Expense Ratio	1.01%

**PORTFOLIO MANAGER**

Katherine Schapiro	12/15/2005
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\*millions \*\*for amount invested less than \$25,000

\*\*\* 1 month after purchase

Data through: 12/31/2007

Source: Company Documents; Lipper

Ticker staff searches for mutual funds for their consistency in performance and durability of investment style.

Our interview covers investment philosophy and strategy, research process, portfolio construction and risk control for funds. Through an interview we uncover long-term strategies and processes that help to generate long-term returns.

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