

Conservativeness in a Global Context

Barnaby Wiener, the manager of MFS International Value, combines a conservative approach to managing investors' money with bravery when he has enough confidence in a story. He doesn't like grand projections on the direction of the world and stays focused within his expertise – bottom-up stock selection, which involves careful evaluation of both the upside and the downside potential.

Q: How would you describe your investment philosophy?

A: The core of my philosophy is that long-term thinking leads to outperformance. There is a huge pressure on people to take a short-term view to generate short-term performance. That pressure is increasing and if you remain longer-term than the market, you are winning. Bearing that in mind, I am focused on finding companies trading at a discount to their intrinsic value. To figure out what that intrinsic value is, it is important to find companies with a relatively stable stream of earnings.

I shy away from companies in a rapid growth phase, because it is difficult to predict the long-term prospects of these businesses and impossible for me to make a sensible valuation. Equally, I shy away from businesses that are at risk of extinction or decline, again because it is hard to establish the baseline of profitability.

There are two basic types of companies in the portfolio. The first type is companies that give me a very high degree of confidence in the durability of the business because of the management team, the franchise, the domi-

nant market share, the long term track record of high returns, or, hopefully, a combination of these factors. I must have the confidence that this is a first grade company, regardless of the current operating environment or the phase of the cycle.

With these companies I am more flexible in terms of valuation. The second type fits more into the category of OK company, great price. Here I'm much more rigid on valuation. I use a variety of different metrics to measure valuation, and I also look for clear signs of adverse sentiment (e.g. lots of sell recommendations and negative commentary from the analyst community).

Q: Do you consider mega trends, such as the growth in China, the Eastern European markets benefiting from the EU expansion, or the growth in India?

A: Not really. All I can observe is that China, India etc have been great growth stories over the past few years, but I have no visibility as to how sustainable that is. Frankly the myriad of political, economic and social factors which determine macro-economic developments is too complex for me to

MFS International Value

Fund Facts

Symbol	MGIAX
Website	www.mfs.com
Address	MFS Investment Management 500 Boylston Street Boston, MA 02116
Tel. No.	1-800-343-2829
Inception	10/24/95

Portfolio

Total Net Assets *	\$ 385.1
Avg Mkt Cap (\$ Weighted) *	3,930
Average Price/Earnings Ratio	12.1
Average Price/Book Ratio	2.1
Turnover Ratio	37 %

Investment Information

New Investment	Open
Min Initial Investment	\$ 1,500
Min Subsequent Investment	\$ 50
Min Initial IRA Investment	\$ 250

Risk (Against MSCI EAFE - 3 Years)

Alpha	0.44
Beta	0.81
R-Squared	0.92
Ann Std Deviation	11.45
Sharpe Ratio	0.45

Returns vs. Lipper Intl Multi-Core Index

	MGIAX	Index
1 Year (Cum.)	25.95 %	24.08 %
3 Year (Ann.)	21.01 %	17.85 %
5 Year (Ann.)	5.94 %	2.43 %

Returns vs. MSCI EAFE

	MGIAX	Index
1 Year (Cum.)	25.95 %	24.09 %
3 Year (Ann.)	21.01 %	18.73 %
5 Year (Ann.)	5.94 %	1.63 %

Fees and Expenses

Max Sales Charge - Front	5.75 %
Max Sales Charge - Deferred	0.00 %
Max Redemption Fee	0.00 %
Total Expense Ratio	1.65 %

Portfolio Manager

Barnaby Wiener	Oct-03
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* millions

Data through: 08/31/05

Source: Company Documents; Lipper



make a judgment call. Given the forecasting track record of the economist community, I suspect it's beyond everyone else as well. I'm much happier investing in areas where the consensus view is overwhelmingly negative, and that clearly is not the case in most emerging markets at the moment.

Q: *Would you describe your research process?*

A: I am fortunate to work with a team of over 20 analysts dedicated to international stocks. They are based in London, Tokyo, Singapore, Mexico City, and I work hand in glove with them. I meet with them on a regular basis, travel with them to visit companies. They are the principal source of idea generation.

Alternatively, I lean heavily on a number of quantitative based valuation models to generate possible ideas. We have an internal quant team and we also use some external tools with specific approaches, such as cash flow return on investment. Screening for stocks whose price is discounting a low level of return, compared to expectations based on their past record, as well as making a qualitative assessment if the market is right in penalizing the company, is another key source of idea generation.

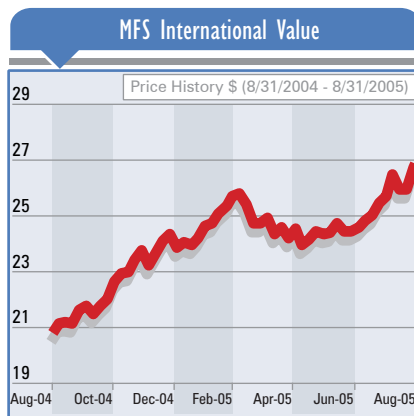
Q: *What are the benchmarks in terms of portfolio construction?*

A: I don't really manage to a set benchmark. My approach is more to make sure the biggest positions are the stocks where I have the highest conviction. Conviction is not just about where the biggest upside is, it's also about where the downside risk is lowest. I am a big believer that you get hurt by stocks going wrong, rather than by missing stocks going up. For the stocks that comprise 2% or more of the portfolio, I have confidence that the downside is modest and the upside is material. At the other end, there are few positions of 0.40% or 0.50%, where the risk profile is higher and the stock could

double or triple. Overall, when I think about positioning, I always consider both the upside and the downside. At the same time, I have a decent spread across sectors as I don't want to be making a bet on just one sector.

Q: *What type of risk control measures do you have in place?*

A: The most important element of risk control is buying the right kind of stocks. I am a fairly conservative investor, always conscious of the downside risk of any story. Probably 80% to 90% of the risk control is buying stocks where the downside is relatively modest. People have spent fortunes in trying to build complex models to manage



risk, but my own view is that measuring risk is a judgment call and can't be done by a computer.

We have an internal quant team that provides help in the process of managing risk, like assessing tracking error. Of course, the tool has its limitations, but it is useful for establishing where the risk in the portfolio is paramount. Once a quarter we do a thorough internal risk review with a detailed assessment. I don't run a particularly concentrated portfolio and I have to make sure the stocks I buy have a limited risk.

Q: *Since you invest across the world, do you try to find global industry leaders? For example, if you consider Hyundai in Japan, should you also evaluate Peugeot in France?*

A: Yes, I think very much on a global basis. If I find a Japanese car company that is more attractive than a French car company, I don't need to worry about owning the French company. In fact, I am both in Toyota and Peugeot because both are attractive in their own right.

Toyota is the lion, stronger in a global context. It is the dominant company globally with a phenomenal franchise in every region of the world and a scale advantage in R&D and production efficiency. I think that the scale advantage is only going to get bigger, so for me that's the best position in the auto sector.

Having said that, I own Peugeot also. Although it is not as well positioned globally, it is a very cheap stock and very well-managed in the context of the European car sector. It generates a decent return, not spectacular, but covering its cost of capital. That's the rationale for owning both stocks.

To give you another example, in consumer staples I didn't own any stocks outside of Europe until recently, just because the European stocks are much more attractive than the Japanese stocks. In technology, it is the other way. I can barely find any European technology stock that look interesting, whereas Japan and Korea provide the largest tech positions I hold.

I am buying companies that have better position in terms of global franchise, more attractive valuation, and a global view. All of our analysts are encouraged to think globally, although they tend to be focused on a specific region.

Q: *Do analysts present their ideas to the portfolio manager or is there a team looking at the same idea together?*

A: It is a team process. Each stock has a specific analyst responsible for covering it, but on occasion the analyst will be prompted to look at a certain stock by the portfolio manager. Sometimes he finds an idea and I receive an e-mail about it. But no one has a monopoly on an idea. We are all

on the same team with the goal to provide benefit to our clients and there is a lot of idea sharing. I spend most of my day interacting with the analysts, traveling to the companies or just in the office, chatting on the phone. It is an interactive process.

Q: *Are investment themes part of your strategy?*

A: Yes, there are plenty of examples of themes in the portfolio. From a geographic perspective, we have a reasonable bet on Korea. Even though Korea is not part of the benchmark, it represents about 4% of the portfolio, purely on the basis of valuation. Korean stocks trade at very significant discount to their global peers, so you keep finding cheap Korean stocks. It is driven from the bottom up, not top down.

We are also playing the energy theme consistently, trimming it down somewhat, but still keeping a significant position. I believe that in commodities, the key driver is not demand, but supply. We haven't been investing in steel and have been barely playing the metals & mining stocks, just because I have no confidence in the long-term supply side of these industries. Oil seems to be the one area where companies are generally struggling to grow production, so the supply and demand scenarios are well supported.

The one concern that I have regarding the energy theme, and the reason for cutting it back, is that only the companies that are able to maintain production growth, replenish their reserves when oil prices hike, and the oil service names will be able to benefit from the trend. We also like autos, telecom, and consumer staples because they are relatively cheap, but these are things that come up on a bottom-up basis.

Q: *How patient can you afford to be, having in mind that fund performance is reviewed and measured on a quarterly basis? For example, GE has grown its revenues and earnings more than 10 times in the past 20 years, but the stock has gone up by only 45%. Microsoft has*

also grown in the last 5 years, but investors haven't made a single dollar.

A: I am assessed on a rolling three year basis, so I am encouraged to have a long-term view. The key is to be very careful with your starting point. The

"The key to any investment is thinking about the fundamentals of the business in conjunction with the valuation of the stock. You end up losing money when you fall too much into one trap; when you worry too much about the price and forget about the quality and vice versa."



about **Barnaby Wiener**

Barnaby Wiener is portfolio manager of MFS International Value Fund and of the global total return portfolios of our mutual funds, variable annuities and institutional investment products.

Mr. Wiener joined MFS(r) as a research analyst in 1998. Previously, he was an equity research analyst at Merrill Lynch. Prior to that, he served as an equity research analyst at Credit Lyonnais and as captain in the British Army. He is a graduate of Ampleforth College and Oxford University.

Our portfolio managers are supported by an investment staff of over 160 professionals utilizing MFS Original Research(r), a global, company-oriented, bottom-up process of selecting securities.

investor who bought Microsoft 5 years ago was right about the expected growth, but didn't make money because expectations were too high. I am always sensitive of staying away from highly favored stocks. Value investors often don't get the company right, but get the stock right. Growth investors are the other way round. I don't buy companies where market expectations are too high and you cannot be confident in the upside potential. The way I measure expectations is through basic multiples, earnings or free cash flow.

Q: *Could you give us some examples?*

A: I have invested in Renault, a French car company, which owns a substantial part of Nissan and Nissan owns part of Renault. The man who turned Nissan from a company almost out of business to the highest margin volume car manufacturer in the world, Carlos Ghosn, has just taken over as a CEO of Renault.

To me it is almost inevitable that these two companies will merge at some stage. Just by doing the deal, a great amount of value will be created, let alone the value created by the synergies of putting the two businesses together. Nissan has limited presence in Europe, while Renault has no presence in the US or Japan, so a merger would create a global car company.

I view the merger as inevitable and hold Renault because there is very limited downside. Yet, the consensus view is just the opposite because of things like "cultural differences" between Japan and France, so the stock price does not reflect a possible merger. It may happen in 5 years and suddenly people will be turning into buyers of Renault at 30% or higher. Renault will be considered a buy because of the synergies generated by this merger. Often people need to wait for confirmation and that is the surest way of not making money on the market. One of the keys to successful investing is being brave. You have to be brave, to be prepared to stand out, and be prepared to look stupid. ■

TICKER Staff