

Global Small Cap Search

Growth portfolios are associated with more risk but Joseph Axtell, the manager of the DWS Global Opportunities Fund, believes that if you have the flexibility to look for growth anywhere, you can control your risks better. He manages the fund with maximum choices not only in terms of locations, but also in terms of market cap and growth type. A crucial aspect for finding opportunities is the input from Deutsche Bank's local analysts all over the world.

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

A: From a philosophical point of view, the most important differentiator of our fund is its flexibility. It is a stock-picking fund that allows us to go anywhere to find opportunities, and the flexibility is really its cornerstone. We use that flexibility to help find growth and help mitigate risk, which is the essence of our process.

As global small and mid-cap equity investors, we can invest almost anywhere in the world. We can move the portfolio to higher-growth markets or to better-value markets and we can benefit from the currency diversification as well. Most people assume that Global funds are riskier than the U.S. funds but, in fact, their risk-adjusted returns show a different reality. Overall, I believe that small-cap investors should consider global markets as their primary small-cap exposure.

We also have flexibility along the entire growth continuum from stable growth to high momentum growth. We have flexibility in terms of market cap as our holdings range from \$250 million to \$5 billion. Finally, since the fund is relatively small, we don't have the size issues

of many of our competitors. That gives us the latitude to go into less covered names and still maintain an adequate level of liquidity.

Q: Do you also include the U.S. market in your definition of 'global'? How is the fund distributed across geographic locations?

A: We look everywhere to find small-cap growth and we construct the portfolio on a stock-by-stock basis. Currently, the portfolio is distributed 40% in the U.S., 40% in Europe and about 20% in Asia and Latin America. We don't have any investments in Africa and the Middle East, although we've been researching that region as well. Overall, our strategy is focused more on the developed markets.

Compared to our benchmark, the S&P/Citigroup Extended Market Index, we have an overweight in Europe and an underweight in the U.S. That overweight is the result of our bottom-up analysis. For example, if we are looking at two growth airline companies in Europe and the U.S., we consistently find that we are getting cheaper growth in Europe. That has been the case across many different industries since I took over the fund about four years ago.



JOE AXTELL, lead portfolio manager, has over 22 years of investment experience, joined Deutsche Asset Management in 2001 and became portfolio manager of the DWS Global Opportunities Fund in November 2002.

He holds a bachelor's degree from the Carlson School of Management, University of Minnesota. Joe is a managing director of Deutsche Asset Management and is a CFA charterholder.

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Q: Does the cheaper stocks on growth basis translate into better returns?

A: That's a good question. In the last four years the overweight towards Europe has generated good returns for two reasons – the equity returns have been better in Europe and we also got a big benefit from the currency appreciation. At this point we see the value gap closing and therefore, in terms of new opportunities, there is less relative value advantage in Europe.

Q: Could you highlight your research process? How do you generate ideas?

A: As part of Deutsche Bank, our primary advantage is the research platform that we have. There are 700 investment professionals in 19 different markets in our organization. More than 200 of them are equity specialists and more than 40 are dedicated small-cap specialists. We have local offices with analysts and portfolio managers in many places around the world and we can leverage their work in the local markets.

The internal research through our global platform is one of the ways to generate ideas and a key advantage because very few of our competitors, especially in the small-cap space, have dedicated analysts in so many locations. In most of the other firms there are several people in an office in the U.S., who rely mostly on outside research.

Q: What's the process of turning an idea into a holding?

A: There are many different styles throughout the Deutsche Asset Management platform and, therefore, we have to make sure that an idea fits with our portfolio. First, we have to satisfy ourselves with the analysts' price target. We examine the valuation and decide if this is a relevant way to value this company. Then, we screen it against our qualitative scorecard, which involves six key attributes that we consider para-

mount to the success of a small-cap investment. We try to find companies that are strong in all these categories.

The first category is management quality, including the management's track record and its strategic vision. We also see if ownership interest is aligned with that of shareholders. The second area is the competitive positioning of the company. We look for leaders in their niche and we measure them on our third criterion, which is earnings stability and sustainable revenues. Innovation is another important aspect as we are looking for companies that can generate growth through new products, new channels of distribution, or new geographies. The industry dynamics is also important and we prefer companies that are well positioned in growth industries. Finally, we examine the balance sheet and the cash flow generation to find companies that can fund their growth internally.

Another important element of our process is what we call the four 'building blocks of growth.' We have identified four growth categories and we classify each company in one of these categories. That approach allows us to balance our growth exposure.

Q: Would you explain those four growth categories in more detail?

A: The first category is stable growth - it represents the core of our portfolio, or 40% to 60%. These are companies with high recurring revenue and almost linear type of earnings growth. The second category, which is also fairly significant at 15% to 35% of the portfolio, is growth at value prices. These are companies with unrecognized earnings potential, where the valuation is very relevant.

The third category is high explosive growth, which consists of companies with high momentum and earnings growth potential. In that case the valuation is less relevant, but the business model and the management's ability

to execute are crucial. Because of the higher-risk nature of these companies, their exposure in our portfolio is usually 10% to 20%. The last category, contingent growth, consists of companies for which we can identify a near-term catalyst that will turn them into growth companies. Because of their unusual growth nature, their presence in our portfolio is limited to 10% to 20%.

This snapshot of our positioning in terms of the growth characteristics helps to identify whether we are aggressive or defensive, and whether that is appropriate in the current market and economic conditions. Also, whenever we buy or sell a stock, we can examine the impact of the purchase on the growth dynamics of the overall portfolio. But most importantly, we can balance and diversify the growth characteristics of the fund, which lowers the risk profile of the growth-oriented portfolio.

Q: Could you give us some stock-picking examples that illustrate your process?

A: A good example of our opportunistic approach would be Fresenius Medical Care, the German renal care company. This is currently our largest holding but when we bought this stock in 2002, it had dropped down from about 100 euro to 20 euro for two main reasons. The CEO was trying to change the business model and to switch from reusable dialyzers to single-use dialyzers. The short-term impact was negative and the company missed earnings for two quarters and the stock fell. But as I got to understand the business, I saw the substantial cost cuts in the long run.

Another reason for the decline was a general misunderstanding about a lawsuit. It was a case of fraudulent conveyance, but because it involved asbestos litigant W.R. Grace & Co, and because Fresenius was only covered by German and European analysts, most investors assumed it was an asbestos suit.

Having a global team, we could see that there could still be damage to the company, but we expected only a small settlement. In November 2002, after building up a position in the company, it settled for only \$15 million and the stock immediately went up 30%.

In another example, the knowledge of the dialysis care industry took us to a little company called NxStage Medical. The company developed a small portable device for home hemodialysis, which provides better quality of life for the patients who need to spend many hours weekly at clinics. The home method is appropriate for only 10% to 20% of the patients, so it won't take away all the Fresenius business. The management is solid and we like the business model. They have a lead of several years on any competitor because they have the only FDA-approved machine.

Q: Could you highlight your portfolio construction process? How many stocks do you have and what is the turnover?

A: At the end of the year we had about 110 names in the portfolio; usually we have between 90 and 120 names. We believe in the concept of the life cycle of global opportunities and we try to invest in the small-cap companies in their early stage of growth. We may own them for three or five years, whatever it takes to grow to above \$5 billion in market cap and appear on the radar of the large-cap managers. Once the liquidity enters the name at above \$5 billion, we harvest the gains and sell these stocks to the large-cap managers.

But we are not forced to sell a successful stock just because it exceeded a certain market-cap level and, generally, we let our winners run. Many traditional small-cap managers are handcuffed by their market-cap limits, while for us such strict rules don't make sense. Our market-cap limit of \$250 million to \$5 billion refers only to the time of pur-

chase, so we have enough room to let the winners run.


The turnover is very low, between 20% and 40% on average, because of our long-term investment horizon. The low turnover keeps down the transaction costs and the market impact costs and provides benefits from a tax perspective. Last year, for example, over 98% of our payout was a long-term capital gain.

Q: What risks do you perceive and how do you manage them?

A: Our benchmark, the S&P/Citigroup Extended Market Index, is a developed market benchmark, while we manage money with a growth tilt. So we deviate substantially from the benchmark, but we are benchmark aware when we talk about risk control. Although the benchmark doesn't drive our investment process, we are cognizant of how we deviate by sector and by geography.

One of the risks in the small-cap space is the liquidity risk. Therefore, if we invest in a liquid stable-growth name, we build larger positions. But if we buy higher-risk or contingent-growth names, especially at the smaller end of the market-cap range, we hold smaller positions. We also have an equity risk team that provides monthly risk overviews so that I can determine if there are any unintended risks in the portfolio. But this is really a stock-picking fund, so the exposure is mostly the result of our bottom-up analysis.

Q: Do you believe in thematic investment within the small-cap universe?

A: We stick to the bottom-up approach but we leverage our knowledge. The beauty of being a global investor is that we identify a theme in the United States, and see if we can find similar companies in Europe or Asia. For example, one theme that originated in Europe was the consolidation of the world exchanges. We were able to invest in several exchanges globally and to benefit from that. 

DWS Global Opportunities Fund

Symbol	KGDX
Website	www.dws-scudder.com
Address	DWS Scudder 222 South Riverside Plaza Chicago, IL 60606-5808
Tel. No.	800-621-1048
Inception	04/16/1998

PORTFOLIO	
Total Net Assets*	\$820
Avg Mkt Cap (\$ Weighted)*	\$4,500
Average Price/Earnings Ratio	24.58x
Average Price/Book Ratio	5.12x
Turnover Ratio	29%

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$1,000
Min Subsequent Investment	\$50
Min Initial IRA Investment	\$500

RISK (AGAINST S&P/CITIGROUP WORLD EMI IX- 3 YEARS)	
Beta	1.19
R-Squared	82.97
Ann. Std Deviation	12.34

RETURNS VS. S&P/CITIGROUP WORLD EMI INDEX		
	KGDX	Index
1 Year (Cum.)	14.94%	16.09%
3 Year (Ann.)	20.95%	19.65%
5 Year (Ann.)	17.30%	17.74%

RETURNS VS. MSCI WORLD INDEX		
	KGDX	Index
1 Year (Cum.)	14.94%	11.23%
3 Year (Ann.)	20.95%	14.02%
5 Year (Ann.)	17.30%	7.39%

FEES AND EXPENSES	
Max Sales Charge - Front**	5.75%
Max Sales Charge - Deferred	1.00%
Max Redemption Fee	2.00%
Total Expense Ratio	1.76%

PORTFOLIO MANAGER	
Joseph Axtell	11/20/2002

*millions **for amount less than \$50,000

Data through: 03/31/07

Source: Company Documents; Lipper

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