



# An Investment Veteran Speaks His Mind

## Credit Suisse Small Cap Value A

### Fund Facts

Symbol	WFAGX
Website	<a href="http://www.creditsuissefunds.com">www.creditsuissefunds.com</a>
Address	Credit Suisse, 466 Lexington Avenue, New York, NY 10017-3174
Tel. No.	800-225-8011
Inception	02/08/67

### Portfolio

Total Net Assets *	\$157.00
Avg Mkt Cap (\$ Weighted) *	\$1,100.00
Average Price/Earnings Ratio	22.16
Average Price/Book Ratio	2.23
Turnover Ratio	54.00%

### Investment Information

New Investment	Open
Min Initial Investment	\$2,500
Min Subsequent Investment	\$25
Min Initial IRA Investment	\$500

### Risk (Against Std Index - 3-yr Average)

	WFAGX	Category Avg.
Alpha	19.23	14.27
Beta	0.64	0.78

### Returns vs. Category

	WFAGX	Category Avg.
1 Year (Cum.)	-6.87%	-14.25%
3 Year (Ann.)	9.76%	1.10%
5 Year (Ann.)	4.92%	2.72%

### Returns vs. S&P 500

	WFAGX	Index
1 Year (Cum.)	-6.87%	-23.02%
3 Year (Ann.)	9.76%	-13.84%
5 Year (Ann.)	4.92%	-1.33%

### Fees and Expenses

Max Sales Charge - Front	5.75%
Max Sales Charge - Deferred	0.00%
Redemption Fee	0.00%
Total Expense Ratio	1.33%

### Portfolio Manager

Management Team	---
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\* millions Data through: 01/18/03

Source: Company Documents; Lipper

When Credit Suisse Asset Management acquired Donaldson, Lufkin Jenrette (DLJ) in November 2000, the firm also inherited one of Wall Street's most outspoken critics of accounting practices, Stanley Nabi. Aside from his duties as managing director, Nabi also directly manages CSAM's large-cap and small-cap value funds. According to surveys conducted by Lipper, both funds have consistently ranked in the top quartile for their respective categories for the past three-year period. In this interview, the Wall Street veteran lived up this reputation as an asset manager who is not afraid to speak his mind.

*Q: I realize I'm talking to a key strategist as opposed to a specific fund manager. I'm assuming your chief role is that of managing director at CSAM.*

*A: I directly manage and pull the trigger on the large cap value and small cap value funds. I'll tell you how we approach both of these funds. When we select the stocks for both of these funds, we follow five very rigid principles before we go to the next level of analysis for the companies. The five principles apply to both the small-cap and the large-cap funds. The first principle is we don't buy anything we don't understand. By that I mean we have an understanding of what the size is of the market in which the company operates, the nature of the competition, etc. However, that doesn't mean we literally don't buy anything we don't understand. I can't build a car. But I know the automobile industry. I know the capacity in the world. I know the relative costs of labor. I know the nature of competition and so on and so forth. So I can make a decision; I hope an enlightened decision. But that's what I mean by something I don't understand - we did not buy into the Internet craze or things of that nature in the late 1990s.*

*Q: I actually printed an interview from a French publication in which you advised*

*investors to avoid Internet stocks and to liquidate current holdings.*

*A: Fidelity Magazine, at the end of 1999, interviewed me extensively and I used some data developed at the time as to what the Internet stocks and collectively publicly traded stocks were trading at, what relationship that was to revenue and earnings, and how crazy it was. Finally, even those who agreed on my study finally succumbed because of the pressure from clients. In the value sector here, we did not.*

*Q: In other words, you stood your ground and decided to take the pressure no matter what.*

*A: As I said at the time, I'm going to speak my mind and pay the price. In the short term, there was a price. I was under intense pressure to change my mind. But in the final analysis, I came out okay. The second principle we follow is we don't buy the stock of any company whose balance cannot survive an ugly recession.*

*Q: There are some balance sheets that suggest they aren't going to survive. They're just too mired in debt.*

*A: Of course, you wouldn't find me dead buying an airline stock. That is not*

a recent opinion. This is an opinion I've held for over 35 years. This is an industry with a death wish. The balance sheet of the industry superficially sometimes looks good. But if you look under the hood, their balance sheets are awful. I don't know how this industry is ever going to survive without very strict regulation.

*Q: How are we going to keep flying around in planes around the world?*

**A:** We're going to fly planes, but they're not going to make any money. This may shock you, but this industry has not made any money in its entire history. Let me take you back to about three-and-a-half years when oil went down to about \$10 a barrel.

*Q: It was like a gift to the world.*

**A:** That's right. Everybody jumped up and down and said, "Look at how much money the airline industry is earning. This is a new industry. This is a growth industry." That was stupid, if I may say so. If you had looked at how many gallons they used and at what price each year, any junior in high school could take a pencil and tell you that more than 60% of their earnings came from lower fuel prices. Fuel is the second largest cost of an airline. The first is labor, obviously. This is what I mean when we don't buy any company whose balance sheet cannot survive in a recession. You go back and look at what industries ranked at the peak of the cycle, but their financial position deteriorates so rapidly in an economic decline that when they get to the bottom they're gone. Many years ago,



we had about 20 major steel companies in this country. I don't mean the steel benders. I mean steel producers. Today, we have two large ones, four or five small ones, and the small ones are really very tiny, and they're all struggling.

*Q: The steel industry in the United States has been an imploding industry for a long time.*

**A:** Right. The third principle we follow is we mouth the price/earnings ratio and we mouth the word earnings, but I don't care much when it comes to the earnings under generally accepted accounting principles. Now this is something that I incidentally taught for many years at the graduate school of business at Fordham University. Two years ago I gave a lecture on quality of earnings and quality of accounting, a two-hour, twenty minute lecture to my class. I started with one statement: that generally accepted accounting principle is currently legalized fraud. I stand by that. Even today, I think it remains so.

There are a lot of loopholes there. What I did with my students is I would take a balance sheet or an operating statement of any industrial company and then I showed them how, without ranking, without violating generally accepted accounting principles, I can increase the profit by 50% and lower it by 50% and nobody can accuse me of violating the rules. So how can you rely on earnings to place a value on a company? The way we place a value on a company is by using cash flow from operations, not just cash flow, because cash flow can come from all kinds of sources. That's what Enron did.

*Q: Yes, it's very difficult to lie about cash flow.*

**A:** Incidentally, to layer out the cash flow, it's very obvious that you have committed fraud, whereas to layer out the earnings, there is a way out based on generally accepted accounting principles. One of the things you're going to see is a lot of the people who are now in the press

having this or that fraud in their company get away with it. And you know why? They're going back to the courts, and they're going to say, "Tell me where the accounting rules say I can't do what I did?"

*Q: Based on what you said, you wouldn't pay much attention to it and you're telling people based on what you said not to pay attention to it.*

**A:** I don't pay any attention to earnings, but I pay attention to cash flow. I think the most important thing about cash flow is it tells you whether the company, from its own operations, is generating enough liquidity to support its growth. Now companies tell you that they're going to grow 12%, 15%, 18%, when I meet with them. I'm meeting with one this afternoon. I say, fine, you're going to grow by 15%, but show me the money. Tell me how you are going to finance that growth. You're certainly not going to be able to raise prices, not in a global economic environment where there is no pricing power, and certainly you're not going to be able to grow 15% without increasing your inventories and building a new plant. Tell me where the money is going to come from, because if you go out and borrow for what you are going to do, you have to sell debt at 5.2%, or sell equity. What does that do to my holdings? Don't tell me you're going to grow at 15% because you can't grow at 15%. You can't show me the money. Now the fourth principle we follow is that it is not enough for us to be told that this company is going to grow at 13% or 14%. We want to know where it is going to come from. Tell me, is it from

new products, gaining market share against the competition, opening new geographical locations where you sell new wares or provide new services, improving profit margins from raising prices, or does it

ised over the last four or five years, and what proportion of that has it delivered? Now, I recognize that there are a lot of potholes on the road that one cannot forecast. There are currencies you can't forecast.

We structure the portfolio by not only emphasizing individual companies but also emphasizing sectors. For instance, we're over weighted health-care. We're also over weighted what we call "chicken cycli-

cals" - companies that are not deeply cyclical, but are only moderately cyclical - manufacturing companies that are sometimes known as producer durables.

**Dave Jennings** ■

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*I stand by that. Even today, I think it remains so."*

**Stanley Nabi**

come from acquisitions. If they say that the growth comes from acquisitions, it sickens me. It has been proven in more than one study, that 70% of all acquisitions are failures. Don't think that I will be impressed by growth from acquisitions.

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*Q: That to me suggests a management style of throwing it against the wall and seeing if it sticks.*

**A:** Exactly. Finally, the fifth principle involved is we grade managements. And you ask, how do you grade managements? We go back four or five years, and ask ourselves the question, based on the information that is available: What has this management prom-

Weather you can't forecast. Political pressures you can't forecast. And I allow them for 15% of that. So if they deliver 85% or more of that, I am happy. If they deliver significantly less than 85%, I have a problem. And I have to adjust my valuations accordingly. If it gets down to much less than 85%, I don't want to be anywhere near the company.

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*Q: Is there anything else you'd briefly like to comment on?*

**A:** These are the five principles that we use for large-cap value and small-cap value. Then, we separate them. With the large-cap value, we don't have liquidity problems. We can buy and sell almost as much as we want to for the fund.

Stanley Nabi is a managing director of Credit Suisse Asset Management. Mr. Nabi joined CSAM in November 2000 when DLJ Asset Management merged its business with CSAM, where he served as vice chairman as well as chairman of the investment policy committee. Prior to joining DLJ in 1995, he spent ten years at the Bessemer Trust Companies where he was an executive vice president and chief investment strategist. Previously, he was a general partner and the chief investment officer at Lazard Freres & Company. Mr. Nabi received a BA in Economics from Columbia University and pursued doctoral studies in Economics at New York University. He has served as president and director of the New York Society of Financial Analysts Federation (currently AIMR) and as investment advisor to the National Bureau of Economic Research. He is a former professor of finance and investments at Fordham University's Graduate School of Business and a consultant to the United States Steel and Carnegie pension funds.