

# Growth at a Discount

*The top priority behind the management of the American Beacon Large Cap Value Fund is to build solid relationships with sub-advisors that share a core value philosophy, says fund manager Adriana Posada. The sub-advisors select stocks with above-market earnings growth potential which are also selling at a discount to the market. To determine a company's growth prospects, they use a combination of internal and external research and analysis of economic trends.*

## **What is the investment philosophy of the fund?**

There are different styles of value managers. We describe our philosophy as 'Growth at a Discount.' We like to buy growing companies when they are cheap but also companies that we expect to overcome the issues they have and produce better-than-market earnings three to five years out.

## **How do you measure growth? What kind of growth do you consider investing in?**

This is a fund of multiple sub-advisors and they each manage their portion of the Fund in accordance with their time-tested process. We are very careful when we select them, to make sure that their normal process is a good fit with our definition of growth at a discount.

Before we hire our sub-advisors, we monitor their portfolios by plotting every one of their securities on two metrics. We take the price to earnings ratio where the earnings is the normalized five-year expected earnings and the Investment Growth Rate (IGR). We like to see the majority of the companies, or 85% of them, qualify as cheaper-than-the-market

on a P/E basis and growing faster than the market on IGR basis.

We rely on the sub-advisors' expertise to determine the forward earnings estimates of the companies that they select. Then we subject them to the same metrics on an on-going basis, so every quarter we look at their portfolios to make sure that they are still made up of companies that fit the description of cheap-but-growing.

## **How do you define the investment growth rate?**

Investment growth rate is the compound rate at which a shareholder's pro-rata equity in the earnings of a company will grow in the long run if the shareholder reinvests all dividends. In other words, earnings growth plus yield.

## **Do all the managers that you have follow the same thinking?**

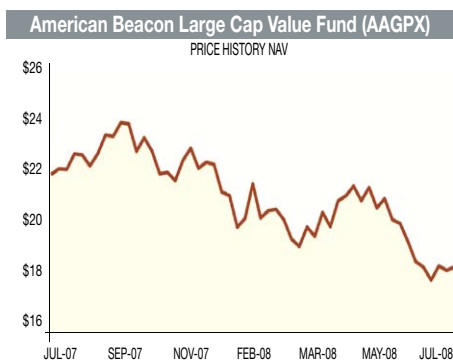
The Fund has four managers and they are all traditional value managers. Two of our four sub-advisors have a more than 20-year record managing assets of this Fund.

Barrow, Hanley, Mewhinney &



**ADRIANA POSADA** joined American Beacon Advisors in 1993 and serves as Manager, Trust Investments for American Beacon Advisors. She is responsible for monitoring the external domestic equity and fixed income advisors to the American Beacon Funds and AMR's pension plans.

Posada received her BS in Mathematics from the Universidad de Los Andes, MS in Mathematics from the University of Houston, and MS in Actuarial Science from the University of Michigan.



Strauss in Dallas, Texas, basically identifies companies that have three characteristics —a price-to-earnings ratio and price-to-book value that is lower than the market, and a dividend yield higher than the market.

They review their companies closely and know the financials well. They meet with the management before constructing a portfolio of 35 to 45 companies that is broadly diversified across various sectors.

Hotchkis & Wiley Capital Management in Los Angeles, California is a traditional value manager but the focus of their process is really on earnings. They look to create a portfolio of companies that are cheap on a price to normal earnings basis. Most of their research is internal. They meet with the management of the companies they own and they have a portfolio of about 50 companies.

Brandywine Global Investment Management in Philadelphia screen companies on numerous valuation metrics to narrow their universe down – price-to-earnings or price-to-book, price-to-cash flow, price-to-sales ratio. They are less focused on meeting with management. They get most of their information from the financials and from research, both internal and external.

Once they have narrowed the universe to a group of companies that meet their valuation criteria, they decide how to construct the portfolio given what they think is going on with the economy, interest rates and market cycle. It is a bottom-up research process with a macro view at the time of stock selection.

Metropolitan West Capital Management in Newport Beach, California will first rank their investable universe by quality, and then they will look at those companies that they think are the best quality companies and determine whether, at this point, they

are trading below their intrinsic value. They are also the most concentrated manager with typically only 35 to 45 companies and it is also, by definition, a higher quality portfolio.

Each manager has a different focus to the way they arrive at the ultimate value selection. They are all true, disciplined value managers and their performance will be highly correlated. Yet, over short periods of time, while one of them might be having a bad quarter or year, because of the different focus that they each have, they end up in somewhat different parts of the market and, typically, they are not all underperforming at the same time.

### **What is the process that you use in selecting managers?**

When we determine that we need to find a manager, we go to a database of managers and screen initially for managers that have median or better performance for three or five years.

We use performance just to narrow down the universe, but the focus of our search process goes beyond that to the investment process and the management team. Then, we screen them using that P/E versus IGR model to determine whether it's a good fit with our way of thinking.

We look for firms where the investment team is still in place that is responsible for the last five years of performance. We look for firms that have a disciplined process that is repeatable. It's important, too, that the firm has incentives in place to keep the people and then, equally important, is that they already have at least a second generation on board learning the disciplines.

Once we hire them and as we monitor them, we meet with each of these portfolio managers every quarter. We want to know that the process hasn't changed, that the discipline is intact and the team remains together.

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We are comfortable with short term underperformance provided everything else is in place.

We are very patient. We really are in it for the long haul and we know that our managers buy companies with a three to five year horizon. That can be attested to by the low turnover in the fund. It has generally ranged between 25% and 35%.

### What's your turnover in managers?

We have a very low turnover not only in the portfolios, but in managers. The newest manager on this fund is Metropolitan West. They were added in 2000 and we have not made any changes to fund managers since then.

### How do you deal with the issues related to overlap in securities holdings?

To control exposure, we give each sub-advisor an identical set of guidelines so that they manage their portion of the fund as if it were the whole fund. In that way, if each of the managers decides to put 5% in the same company, still the fund in total would not have more than 5% in that company. Sub-advisors are not allowed to invest more than the larger of 30% or the index weight in any specific sector and they are not allowed to invest more than 15% in any individual industry.

There is some overlap of names. They are all value managers and they may all agree on the same company. At the end of the year, for instance, this portfolio in particular had about 140 names in it. There were 56 names that were common to two or more managers. Only one name was owned by all four of them.

### How did you come up with the idea of multiple manager investment strategy?

Our firm had its beginnings managing the pension assets of


AMR Corporation. Even before we were American Beacon Advisors, the founders of our company were managing the pension assets of AMR Corporation.

They had been successful at managing the pension assets and part of the success was their ability to select and identify managers in a typical pension plan. When we decided to create mutual funds, we chose to replicate what we had been doing in the pension plans for AMR Corporation. That is where the multiple manager idea came from. Multiple managers also help us keep portfolio volatility and risk in check.

### What are the advantages of your way of money management?

There are several advantages. The low expense ratio is a very attractive feature of our funds. Our institutional class of shares for the Large Cap Value Fund has an expense ratio of 60 basis points or 0.60% of total assets under management. Our retail shares are 84 basis points or 0.84% of assets. The institutional class of shares has a high minimum of \$2 million whereas the retail class has a minimum of only \$2,500.

Because of the extra diversification of the multiple managers our portfolios tend to be somewhat less volatile though they are still actively managed bottom-up portfolios, and shareholders get exposure to multiple professional asset management firms.

Our long-term investment horizon leads to low turnover, which means the Fund pays less in trading costs and passes the savings along to shareholders. Low turnover is also attractive for taxable accounts. 

## American Beacon Large Cap Value Fund

Symbol	<b>AAGPX</b>
Website	<a href="http://www.americanbeaconfunds.com">www.americanbeaconfunds.com</a>
Address	American Beacon Advisors Inc. 4151 Amon Carter Blvd Fort Worth, TX 76155
Telephone	800-658-5811
Inception	08/01/1994

PORTFOLIO	
Total Net Assets of the Fund*	\$8,342
Total Net Assets of the Class*	\$4,914
Avg Mkt Cap (\$ Weighted) *	\$58,600
Average Price/Earnings Ratio	11.6x
Average Price/Book Ratio	2.8x
Turnover Ratio	20%

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$2,500
Min Subsequent Investment	\$50
Min Initial IRA Investment	N/A

RISK (AGAINST S&P 500 DAILY REINV IX - 3-YEARS)	
Alpha	-0.11
Beta	1.04
R-Squared	0.93
Ann. Std Deviation	10.66
Sharpe Ratio	-0.07

RETURNS VS. S&P 500 DAILY REINV INDEX		
	AAGPX	Index
1 Year (Cum.)	-16.06%	-11.14%
3 Year (Ann.)	2.04%	3.66%
5 Year (Ann.)	9.66%	6.92%

RETURNS VS. RUSSELL 1000 VALUE TR INDEX		
	AAGPX	Index
1 Year (Cum.)	-16.06%	-14.66%
3 Year (Ann.)	2.04%	3.15%
5 Year (Ann.)	9.66%	8.55%

FEES AND EXPENSES	
Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	0.00%
Total Expense Ratio	0.83%

PORTFOLIO MANAGER	
Adriana Posada	2007

\*millions  
Data through: 07/31/2008; Source: Company Documents; Lipper

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