

Reaping What You Sow



Today, it is people in suits and ties in hi-rises of concrete, steel and glass across America's financial districts who manage the nation's tens of thousands of mutual funds. But one manager has dared to break the mold. Jeff Auxier, who manages a tiny but so far thriving portfolio, performs his research and investment out of what looks like the most unusual place for a money manager - his 2,000-acre hazelnut farm in Oregon. It is in this lavish landscape that Auxier Focus Fund (AUXFX) gained 0.23% for the three years ended March 31, 2003, according to fund tracker Lipper. In the meantime, funds in Lipper's multi-cap core category fell 4.37% on average and the S&P 500 Index declined 16.09%. Since its inception in 1999 the fund has risen 1.7%. Auxier spoke to TICKER about the way he approaches the market and manages money for others.

Q: *What's the main focus of Auxier Focus?*

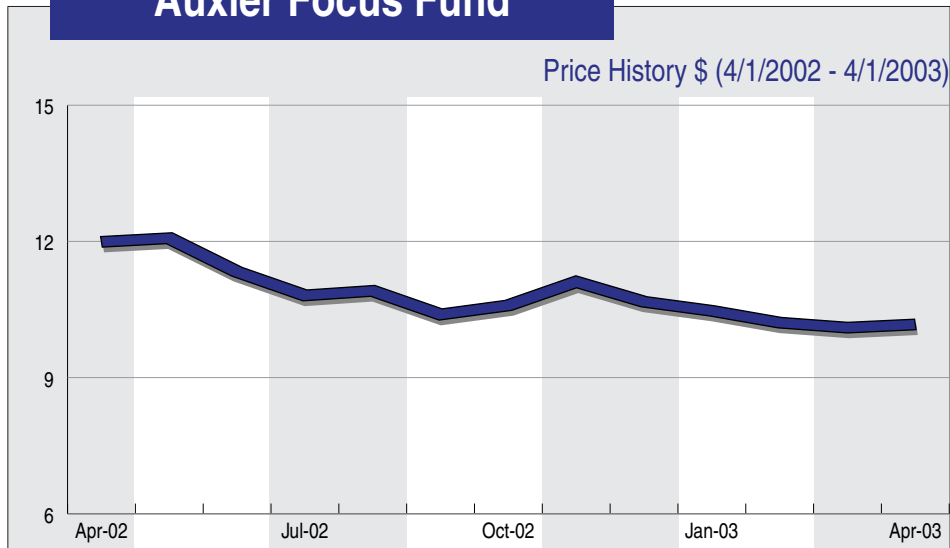
A: The indebtedness of both corporations and individuals has been the worrisome part of the economy. So, we are looking extremely hard at the liabilities part of the balance sheet because that is an area that was not the focus for the late 1990s but has become the focus in this post-bubble environment. There's been a lot more debt than people have realized. The critical thing for us has been to look at the balance sheet for the common stocks. We look at companies that can control their own destinies and that are not tied to the capital markets. We look to see if the companies have three things - price, value and a margin of safety. If they are compelling, it doesn't really matter what their size is. Our history has been in the larger value area but we will look at any kind of company if the management is sensible, the capital allocation policies are sensible, and the price is right. We let the price determine our actions. If the price is really attractive versus the underlying intrinsic value, then we move.

Q: *In the conditions you are describing you chose to be overweight in the large-cap area. Do you think they will perform well in the future then?*

A: We believe that in the long-term everything goes back to the replacement value. So, we look at companies where the companies' trade-in relationship is to their replacement values. We also believe everything goes back to trend. Our analysis focuses on: what's the business worth, what's the trend line, where should it trade, what's the intrinsic value and is it growing, also what's the discount to that intrinsic value? We are always looking for a margin of safety and we want to double and triple play our money. Double and triple play comes from buying solid growing companies at a low valuation and having that valuation and that price expand with it. So, we focus primarily on businesses ahead of time. We want exceptional businesses that ideally have a very strong competitive position that allows them to price their product and allows them to have a lot of excess capital to take advantage of in downturns. We identify ahead of time these great companies and then when the price is there, we move. The categories will vary. Back in 1983 I was buying Waste Management at 9 times earnings and by 1989 it was over 35 times earnings. Waste Management today is lower than it was in 1989. Emerging markets in 1992 were 30 times earnings and 10 years later they are negative because the PE has contracted. So, over

Auxier Focus Fund		
Fund Facts		
Symbol	AUXFX	
Website	www.auxierasset.com	
Address	Auxier Asset Management 8050 SW Warm Springs, Ste 130 Tualatin, OR 97062	
Tel. No.	800-835-9556	
Inception	07/09/99	
Portfolio		
Total Net Assets *		\$20
Avg Mkt Cap (\$ Weighted) *		\$8,116
Average Price/Earnings Ratio		16.14
Average Price/Book Ratio		3.82
Turnover Ratio		56.00%
Investment Information		
New Investment		Open
Min Initial Investment		\$2,000
Min Subsequent Investment		\$100
Min Initial IRA Investment		\$2,000
Risk (Against Std Index - 3-yr Average)		
	AUXFX	Category Avg.
Alpha	6.70	6.82
Beta	0.45	0.79
Returns vs. Lipper Multi-Cap Core Index		
	AUXFX	Index
1 Year (Cum.)	-13.97%	-24.08%
3 Year (Ann.)	0.23%	-15.22%
5 Year (Ann.)	---	-3.62%
Returns vs. S&P 500		
	AUXFX	Index
1 Year (Cum.)	-13.97%	-24.76%
3 Year (Ann.)	0.23%	-16.09%
5 Year (Ann.)	---	-3.77%
Fees and Expenses		
Max Sales Charge - Front		0.00%
Max Sales Charge - Deferred		0.00%
Redemption Fee		0.00%
Total Expense Ratio		1.35%
Portfolio Manager		
J. Jeffrey Auxier		07/09/99
* millions		Data through: 03/31/03
Source: Company Documents; Lipper		

Auxier Focus Fund



18 to 20 years I've followed a lot of companies and there are certain price points that represent compelling value and we would rather play that undervaluation to fair value. We tend to gravitate more towards slower growing businesses that are not a magnet -- a honey pot for capital. That's happened in the past. We've had great industries that have just been swamped with too much capital.

Q: From your experience, can you give us a few examples of how "compounding" works for a successful long-term investment?

A: We are trying to buy a business that has an enduring, consistent high return on invested capital. If we can buy that company at a huge discount to what the underlying value is, then over time if we can buy a solid growing company at a real bargain price, we get to double play. We bought Waste Management, as I said, at 9 times earnings and we sold it at close to 40 times. Ideally what you are trying to do is one, never underestimate the power of compounding, and second, never underestimate the negative effect of torpedoes and downside risk. The first thing we are trying to do is mitigate downside risk. For example, in the early 1990s we bought a lot of small banks during the thrift crisis. We bought Golden State Bank at a very low fraction of what it was worth, and recently we bought out Citigroup and we made five-to-six times our money. This is a case of a solid company; trading too cheap in a crisis and then coming out of the crisis we get the P/E and the earnings expansion. The big reason so many

acquisitions fail is they overpay and you've got to make sure you are underpaying for a growing entity.

Q: Are you specifically looking for a very deep discount?

A: Ideally, the better the price, assuming the fundamentals are solid. But we really look hard at the fundamentals, too. So, we are looking hard at the balance sheet, the cash flows, the accounting, the compensation practices but if we can buy clean earnings -- the lower the price, the better. The balance sheet has become very important because these hidden balance sheet liabilities have been a real danger.

Q: If things aren't exactly transparent when you look at the balance sheet, how do you find out about these hidden liabilities?

A: Just a lot of reading and research, and going to the annual reports and trying to determine what the true liabilities are. There have been so many creative derivatives and other things. A lot of this earnings growth has been manufactured -- leveraging up. GE has a triple A rating on their core business and then they lever up 8-to-1 in their finance business, so much of it is applying a huge amount of leverage on a small incremental game and that's where they are getting the numbers, but the problem is if the leverage goes the other way. So, you just have to go through the government documents, which are the best. You can tell whether accounting is aggressive or conservative. Everyone wants to blame everybody but a

good analyst is going to say 'Hey, that's aggressive accounting.'

Q: Do you visit the companies and talk to their management?

A: Ideally, yes, if we can meet with the management to just get a feel for what they think about capital allocation. What's important is if they are trying to grow through acquisitions or trying to build per-share intrinsic value. We are looking for management that is after growing the value of the business, not just trying to grow an empire. Bad management can sink a good company really fast. All they have to do is make a few overpriced acquisitions and over-leverage the balance sheet and you can pretty much wipe out any business.

Q: You started the fund in 1999 when the market was anything but depressed. Why? Wasn't there shortage of cheap stocks at that time?

A: There were a lot of good companies. The tech stocks were too overpriced but there were many good businesses that were quite undervalued. In 1999 and 2000, they took all their money and put it into tech. So, in March 2000 the whole country had moved into tech. Well, they took it out of companies like All State, which got down to 18, and Phillip Morris which also got down to 18. That was a great time if you were buying good businesses. The indexes became dominated by tech, telecom, and media, which became a bubble. But underneath it there were a lot of good buys. The stocks we bought in 1999 and 2000 helped us out in 2001. The indexes again were dominated by the big-cap tech, telecom, and media stocks but there were a lot of stocks within the index that were really at multi-year lows. So, if you were a business buyer there were a lot of good values there. The indexes had been skewed towards tech, telecom, and media; they had been distorted but a lot of companies within the index were really at good prices.

Q: What is a long-term outperforming portfolio in your view?

A: No matter what they say, if a client is down 30% they are out of the game. To keep a retail client in the game, you have to show them a systematic low-risk approach; otherwise they are not going to stay in the game.

And to keep compounding their money you have to stay in the game. And the thing people don't understand is that everyone says they are long term, but once they drop 30% they are looking out three months. They are not looking out ten years. So, what we are trying to do is again price our purchases. Our movements are based on price/value. If the price is right we move in, if the price

between the price and the underlying value. The key is to know what you are in. We focus on knowing the values day to day and the trend in the values. When the price gets distressed we want to know if that price drop is temporary or permanent. If it's a very strong company with very little debt and the price is down, that could create an exceptional opportunity.

A: My biggest fear is the housing market. There has been a lot of easy money in housing and housing turning down would be a major detriment overall. Japan has 11 straight years where housing has been declining. If someone's house goes down in value, it really cuts down spending. I would say the general level of indebtedness, if that leads to a downturn in housing, could have

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Jeff Auxier

isn't right we don't. We want ideally to beat the S&P index every year but with a fraction of the risk. We beat the index the last three years by a huge amount partly because things have been so overvalued in the indexes, so it's not great management. It's looking at what's in these indexes. If you look back at compounding you've got to fight over time -tooth and nail - to avoid permanent capital losses. So, our benchmarks for clients are if our clients are up, they are fine. If the benchmarks are down 30 it doesn't really matter - they kind of expect it to be up. It's a higher standard but we try to beat the S&P index with a lot less risk.

Q: Did you have larger equity allocation in 2002? Did you view the 2002 market as a good opportunity to move in?

A: Yes, selectively. The third quarter volatility was the highest in seventy years. So, wherever there's fear of volatility, there's opportunity. Wherever there's crisis, there's opportunity. During the thrift crisis in the 1990s the small banks were the number one performing group coming out of the thrift crisis. What you are trying to do is find misappraised companies, so in the auction markets you've got fear and greed, and that allows a lot of mispricing. That creates the opportunity to exploit the discrepancies

J. Jeffrey Auxier, President and Chief Executive Officer

In 1982, Jeff began his career at Foster Marshall-American Express (now Salomon Smith Barney). He became a member of the Smith Barney Portfolio Management Advisory Board, member of the Chairman's Council from 1990 to 1996, Senior Vice President of Investments and Senior Portfolio Management Director. In 1998 he left Smith Barney to start his own investment advisory where he manages about \$200 million dollars, and now, the Auxier Focus Fund.

Q: Do you still have a portion invested in bonds or in cash?

A: We have about 9% in cash but we've been playing equities in the senior debt and the bank type of situation. I think that's a really good way to play equity. That security class will outperform the market generally over the next two years with a lot less risk. So, we are applying the equity analysis to the balance sheet and we are buying mispriced senior corporate debt instruments. Because of all the borrowed money, the first step for these corporations will be to clean up their pension liabilities and their balance sheets.

Q: What is the greatest danger to a large-cap value portfolio like that? What would you hate to see in 2003?

a huge ripple effect. If the money is really easy, you have to run away. All these bubbles have occurred because of too much easy money. A lot of people buy houses for the wrong reasons. But that's a general macro worry.

Q: If that happens, what will be the mechanism by which large caps will be affected?

A: Again, it's hard to generalize but you have to look at each company and at their pensions, if they have a deficit or surplus, and you have to break it down. There are sectors that look really good in the large cap. There are so many different situations and companies that are at 10-year lows versus other companies. So, it's hard to generalize.

Jana Tchinkova ■