ADVERTISEMENT FEATURE

INVESTING WITH A MARGIN OF SAFETY

Managing risk in investments is obviously important to the bottom line, but it is also a fundemental to the health of the human mind, which associates it with physical pain or fear. Franklin Templeton's Luxembourg-based SICAV range consider managing risk as an important part of their investment process

Based on his experience of working for one the world's largest global asset managers, Patrik Silfverling, head of the Nordic region for Franklin Templeton Investments believes that Nordic investors, like the rest of the world, do not like to lose money.

Mr Silfverling cites recent scientific research by the Wellcome Trust Centre for Neuroimaging at University College London that proved the human brain processes the experience of losing money in a similar way to physical pain or fear. He believes that the concept of reducing this "financial pain" by using funds that consider managing risk as an important part of their investment process, may be one of the reasons that Franklin Templeton's Mutual Series funds, part of their Luxembourg-based SICAV range, are gaining interest from distributors.

The Mutual Series philosophy began in 1949 and has been the foundation for all Franklin Templeton's Mutual Series funds ever since. At its core is a relentless pursuit of value with the aim of delivering solid, risk-adjusted returns, year in and year out to investors. Franklin Mutual Advisers team, which manage all of the Mutual Series funds, believe that if they look after investors' interests and follow the same proven investment strategy, they will be better placed to achieve this aim.

The Mutual Series approach has proved to be successful over the longer-term with the US-registered Mutual Shares Fund* only ever losing money in two of the last 30 years. (*Source: Franklin Templeton Investments as at 31 December 1975 to 30 December 2006, based on the performance of the US Mutual Shares Fund, a US registered mutual fund.*)

The Mutual Series funds in the Franklin Templeton Investments Fund SICAV – Franklin Mutual Beacon (invests primarily in North America), Franklin Mutual European and Franklin Mutual Global Discovery, use exactly the same philosophy as their American counterpart.

BUY LOW, SELL HIGH!

The bulk of Mutual Series investments are in mispriced or undervalued stocks, with viable catalysts that they believe will change the way the market views their true worth. To take this contrarian approach and invest in securities that the rest of the market has overlooked or dismissed requires detailed knowledge of the companies involved. Relying on their own in-depth research, Mutual Series fund managers and analysts examine each potential investment thoroughly by combing through industry publications, scrutinising annual reports and probing company managements, customers and suppliers. They want to identify companies that other investors may have dismissed due to an uncertain issue or complexity that many analysts might find overwhelming to decipher.

In an investment world which has benchmark constraints and can be fixated on tracking error, it can be difficult to act against consensus opinion. Investors do not want to make an investment decision contrary to sentiment which may turn out to be unsuccessful and could result in the pain of financial loss. This is exactly the type of sentiment that presents an opportunity for Mutual Series.

Many believe the adage that they should buy low and sell high but few actually follow this through. With a focus on value and a disciplined and time tested investment process, Mutual Series aims to do just that. The detailed bottom-up company analysis undertaken by the Mutual Series aims to identify company securities that are valued below their intrinsic value, but have a clearly identifiable catalyst the team believes will unleash the value to shareholders.

One example would be Rhoen Klinikum; a leading private hospital in Germany. In 2004, the stock was down 40 per cent from its 2001 peak. At this time the company was being investigated by the Cartel office and there was uncertainty regarding the 25 per cent stake HVB had in the company. The Mutual Series team saw this decline in the share price as an opportunity to invest. By undertaking vast amounts of proprietary, bottom-up research the team identified strengths of the company which the market had overlooked, two of which were high barriers to entry and high growth rates due to an ageing population. As concerns eased over time, the share price appreciated and, by May 2007, it rose by approximately 80 per cent.

ACTING AS CATALYSTS FOR CHANGE

When necessary, the Mutual Series managers serve as the catalyst to release value for investors. For example, they may uncover management teams that, in their opinion, are not taking all the steps necessary to realise a company's potential. In such situations, the Mutual Series team may influence that management into implementing changes they believe will help to maximise the stock's value. They may do this via regulatory filings, letters to management, proxy solicitations or submission of proposals to shareholder meetings.

MERGER ARBITRAGE AND DISTRESSED SECURITIES CAN OFFER BETTER RISK-ADJUSTED RETURNS

As an extension of this deep value approach, a small amount of a Mutual Series portfolio can also be invested in less traditional value opportunities such as merger arbitrage and distressed securities.

Arbitrage opportunities involve companies undergoing change which are often avoided by investors as the market does not like to deal with uncertainty. A corporate event, such as a merger, may present an opportunity to invest in that company's stock at a discount. Mutual Series only invest in merger arbitrage opportunities once the deal has been announced. In July 2006, two of the world's leading steel companies, Arcelor and Mittal Steel merged six months after Mittal Steel launched a hostile offer for Arcelor. In February 2006, Arcelor tried to put up defence measures to prevent a takeover and with the hostility surrounding the deal investors avoided the companies.

Mutual Series saw this as an opportunity and began buying shares at attractive valuations. By May 2006, Mittal had raised their offer by 31 per cent to approximately to €36.60. Arcelor responded by announcing a merger with Severstal. Following shareholder pressure in June 2006, Arcelor capitulated and agreed to merge with Mittall receiving a final 9.8 per cent rise in the offer price to approximately €40.40. The deal closed in July 2006.

Buying securities that appear to be on the point of bankruptcy may seem to defy logic, but Mutual Series have established significant expertise in this field and have a team of dedicated distressed debt analysts. Having uncovered a potential opportunity, the team undertake painstaking research. One example of a typical Mutual Series distressed security investment was NTL, the largest cable company in the UK. NTL were fundamentally a good company with an over leveraged balance sheet. Mutual Series purchased bonds at a significant discount to par and was a member of the creditors' committee. As owners of around 8 per cent of the company's equity Mutual Series played an active role in the company's reorganisation plan and the largest rights offering in over a decade. In the calendar year following emergence from bankruptcy (2003), NTL's share price appreciated 700 per cent.

MANAGING RISK

Managing downside risk is at the top of the Mutual Series agenda. To quote the CIO of Mutual Series Funds, Peter Langerman: "We're focused on risk. We manage it primarily company by company, a bottom-up approach. Looking at each company specifically, determining an asset valuation and buying the security at a discount to that asset value, thereby creating a margin of safety. This margin of safety is intended to protect the funds in downwards and volatile markets."

Undervalued stocks, by definition, are inherently discounted, which we believe reduces risk, helping to limit downside.

Furthermore, Mutual Series' investments in distressed securities and merger arbitrage tend to be affected less by broad market movements than by the specifics surrounding each particular situation. As these type of investments tend to be uncorrelated to the wider market they can make the funds less volatile than the market as measured by standard deviation

As you can see from figure one, the Mutual Series range of investing with a margin of safety and releasing value back to investors has led to some compelling risk/reward profiles across their range of SICAV funds value approach.

Mr Silfverling believes the Team's pursuit of solid returns and lower volatility in all market cycles is one of the reasons that the Mutual Series range is attracting so much interest in Nordic market place.

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Figure one: SICAV fund performance

SICAV Fund	Three years (annualised)		Five years (annualised)		Since launch (annualised)	
	Volatility	Growth	Volatility	Growth	Volatility	Growth
Franklin Mutual Beacon	**6.03**	**14.21**	**8.63**	**9.39**	**10.85**	**9.29**
Equity Global Sector	7.11	12.26	12.03	8.54	15.02	6.29
S&P 500 Index	9.29	16.77	12.02	11.83	13.85	5.78
Franklin Mutual European	**6.83**	**19.80**	**9.35**	**10.93**	**11.41**	**9.92**
Equity Europe Sector	8.28	18.46	14.07	6.84	14.37	0.01
MSCI Europe Index	7.57	20.31	15.05	8.53	15.16	2.24
Franklin Mutual Global Discovery	**N/A**	**N/A**	**N/A**	**N/A**	**8.74**	**23.43**
Equity Global	9.29	16.77	–	11.83	11.06	24.59
MSCI World Index	7.70	17.67		12.71	11.68	23.90

Source: Morningstar, Annualised performance and volatility (based on standard deviation), A share class performance in base currency, Nav-Nav, based on total return to 30 April 2007. Franklin Mutual Beacon Fund launched 7.7.1997, base currency: US dollar. Franklin Mutual European Fund launched 3.4.2000, base currency: euro, Franklin Global Mutual Discovery launched 25.10.2005, base currency: US dollar. Past performance is not a guide to future performance.