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Sumanta Biswas, left, and Bernard Horn find overlooked foreign companies by, well, going out and looking for them. Their team visits nearly 500 companies a year.

Talking With Bernard R. Horn Jr. and Sumanta Biswas

Portfolio Co-Managers,
Pear Tree Polaris Foreign Value Small Cap

Back to Basics

By James A. Anderson

There are many ways to sort through the more than 40,000 stocks listed on international exchanges. But the folks at Polaris Capital Management find there's nothing like packing their bags, talking to management, and getting a feel for the potential problems and opportunities you can uncover only by visiting a company.

Bernard R. Horn Jr., the head of the \$8.5 billion Boston-based global investment firm, has been managing international portfolios since 1980, including subadvising the \$613 million **Pear Tree Polaris Foreign Value Small Cap** fund (ticker: QUSOX) since its inception in 2008. Horn says this is an era of unparalleled opportunity for investors in foreign stocks, noting the major strides in transparency and corporate governance in places such as Japan and Korea.

Horn and his two co-managers, Sumanta Biswas and Bin Xiao, log tens of thousands of miles each year to meet with management. This past February, Horn dropped by a Korean insurer to look for reasons that its shares were undervalued. He soon figured it out: a sizable investment in a nearby meat wholesaler that had just gone bankrupt. And Biswas re-

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cently crossed the Pacific to look over a Japanese metal recycler. The company's financials were intriguing enough to book a meeting with management, but midway through the gathering, a couple of office workers appeared to unveil a new product line—massage chairs. Biswas took that as a signal it was time to move on.

The detective work is also paying off for investors in the \$613 million Pear Tree fund. The fund's five-year average annual return of 13.1% beat 76% of its competitors, according to Morningstar. Its 20.1% return over the past year beat 85%.

The Pear Tree Polaris Foreign Value Small Cap fund clearly has a fairly narrow universe. The 74 stocks in the portfolio have an average market value of \$1.8 billion, much smaller than the category average of \$2.7 billion. It spans at least 15 countries, primarily in Europe and Asia; 18% of its assets are in emerging markets.

The main driver in the initial screening process is what the fund calls maintenance cash flow—their proprietary twist on free cash flow, which is the stream of money a company can generate after the necessary spending to maintain assets and stay in business. The Polaris managers look for a minimum return after inflation; the exact level is determined for each country. They begin looking for the average 7% real return that global stocks have historically offered, and add another 2% because average isn't good enough, and then add a number that correlates with the average local bond yields, to mitigate currency swings and changes in inflation. That translates into a minimum 9.5% for stocks in Japan, and as much as 14% in markets such as Turkey or Brazil. This process leaves 2,500 stocks, 1,400 of which fall beneath the fund's \$3 billion market-cap ceiling.

The focus on free cash identifies companies with money to increase dividends or invest in new projects, or could be attractive acquisition candidates. Moreover, as long as free-cash-flow growth stays

ahead of stock price appreciation, they typically hold stocks indefinitely. That has kept turnover low, about 16% a year since the fund's inception.

After this, the managers and a team of five others pack their bags, grab their passports, and fan across the world to visit 400 to 500 companies each a year. Horn estimates that a fourth of their time is spent investigating companies, local competitors, and political climates.

A few themes are apparent in the port-

and Nihon, 14%.

A second group might be labeled prudent contrarians—solid businesses that buck trends the global investment herd has taken for granted. Take **Go-Ahead Group** (GOG), a British bus operator. The shares were weak when Polaris first climbed aboard at the end of 2016. The stock slid further early this year, thanks to a standoff with drivers and Brexit jitters. But Polaris saw that the company's maintenance cash flow wasn't under threat. It helped, too, that Go-Ahead traded at a very attractive cash flow yield of 13%, with minimal risk.

A healthy amount of cash also allows nimble companies to seize upon new lines of business. The Swedish armored-transport company, **Loomis** (LOOMB.Sweden), is a good example. While the company has held its market share in face of competition from **Brink's** (BCO), it has taken up a second line of business—setting up cash-counting services in the cities where it operates. At a time when pundits have predicted the end of cash, Loomis' addition makes it possible to generate two revenue streams from each of its transport jobs.

Similarly, Hong Kong information-technology maintenance company **VST Holdings** has gone beyond tech repairs to market computer equipment, as well. The company has quadrupled cash flow in the past decade and now boasts a maintenance cash flow yield of 13%.

ONE KNOCK ON THE FUND is its high fees, an issue Pear Tree addressed earlier this year by setting total annual cost at a still above-average 1.47% and a more reasonable 1.09% for institutional shares, which retail investors can buy through an adviser. There is no sales load.

Looking forward, says Horn, the fund's success will lie in fighting complacency. "So often, value managers get into a comfort zone and do one thing over and over again. Our strategy is adaptable to all seasons."

Pear Tree Polaris Foreign Value Small Cap

	Total Returns ¹		
	1-Yr	3-Yr	5-Yr
QUSOX	20.1%	4.5%	13.1%
MSCIACWI ex USA Small Cap Index²	16.3	4.3	10.2
Top 10 Holdings	Ticker	% of Portfolio ³	
Drägerwerk	DRW3.Germany	2.9%	
WorleyParsons	WOR.Australia	2.6	
Prima Meat Packers	2281.Japan	2.5	
Arcadis	ARCAD.Netherlands	2.4	
Crest Nicholson Holdings	CRST.England	2.4	
DFDS	DFDS.Denmark	2.4	
freenet	FNTN.Germany	2.4	
BBA Aviation	BBA.England	2.3	
Loomis	LOOMB.Sweden	2.3	
Taiwan Union Technology	6274.Taiwan	2.2	
Total		24.4	

1-All returns are as of 5/18; three- and five-year returns are annualized.
2-USO 3-As of 4/30. Sources: Pear Tree Funds; Morningstar

folio: For starters, there are well-managed companies with tidy balance sheets, steady demand for their products and services, and sound business models. Chinese textbook supplier **Xinhua Winshare Publishing and Media** (601811.China), is noteworthy for its "stable cash flows and stable end demand," says Biswas. Another, **Nihon House Holdings** (1873.Japan), is a Japanese builder of high-quality custom homes. Polaris calculates that Xinhua has a maintenance cash-flow yield of 10%,



PEAR TREE
FUNDS

The disclosure page must accompany the May 22, 2017 Barron's article entitled "Pear Tree Polaris: Back to Basics".

	2018		Annualized as of March 31, 2018			
	YTD	Q1	1 Yr	3 Yrs	5 Yrs	ITD*
Polaris Foreign Value Small Cap Fund	-2.50%	-2.50%	17.15%	7.71%	10.20%	7.69%
MSCI ACWI ex USA Small Cap Index**	-0.28%	-0.28%	21.03%	10.79%	8.95%	5.69%

* Inception-to-date (Inception date 05/01/2008)

** The MSCI ACWI ex USA Small Cap Index captures small cap representation across 22 of 23 Developed Markets (DM) countries (excluding the United States). With 2,372 constituents, the index covers approximately 14% of the free float-adjusted market capitalization in each country. You cannot invest directly in an index. For comparative performance purposes, the beginning date of the Index is May 01, 2008.

Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. Returns for more than one year are annualized. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. For the most recent month end performance, please call (800) 326-2151. As stated in the current prospectus, the Fund's total annual operating expense ratio is 1.55%. The Fund's annual operating expense ratio has been reduced to 1.45%, effective as of March 31, 2017 through July 31, 2018, due to the Adviser's contractual agreement to waive its fee and/or reimburse expenses to limit Total Annual Fund Operating Expenses. Short-term performance is not a good indication of the Fund's future performance, and an investment should not be made based solely on returns.

As of March 31, 2018, the Fund's largest equity holdings and the percentages they represent in the Fund's portfolio market value were as follows and are subject to change:

Issuer	Percentage of Total Net Assets	Issuer	Percentage of Total Net Assets
Zojirushi Corp	3.1%	Crest Nicholson Holdings PLC	2.1%
Sixt SE	2.4%	IBJ Leasing Co Ltd	2.1%
Cineworld Group PLC	2.3%	DFDS A/S	2.1%
Taiwan Union Technology Corp	2.2%	NIIT Technologies Ltd	2.0%
Ipsos SA	2.1%	Unipres Corp	2.0%

The issuers mentioned in the article have the following percentage of total assets as of 03/31/2018:

Issuer	Percentage of Total Net Assets
Xinhua Winshare Publishing and Media Co.,	1.0%
Nihon House Holdings Co., Limited	1.0%
Go-Ahead Group plc	1.3%
Loomis AB	1.7%
VST Holdings Limited	1.0%

Before investing, you should carefully consider the Fund's investment objectives, risks, charges and expenses. This and other information is in the prospectus, a copy of which may be obtained by calling (800) 326-2151 or visiting the Fund's website at www.peartreefunds.com. Please read the prospectus carefully before you invest.

Investing in foreign markets, particularly emerging markets can be more volatile than the U.S. market due to increased risks of adverse issuer, political, regulatory, market or economic developments and can perform differently than the U.S. market. Small company stocks may trade less frequently and in a limited volume, and their prices may fluctuate more than stocks of other companies. Small company stocks may therefore be more vulnerable to adverse developments than those of larger companies. The Fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual stock volatility than diversified funds. As a result, a decline in the value of the securities of one issuer could have a significant negative effect on the Fund. The Fund may have significant investments in one or more specific industry sectors, subjecting it to risks greater than general market risk. For example, adverse news from just one or two companies in a particular industry can hurt the prices of all stocks in that industry.

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