

THE WALL STREET JOURNAL MAGAZINE

MARCH 2009

SmartMoney

CUT CUT

IN HALF

Humbled by the crash, star fund manager David Winters is counting on some name-brand stocks to pull him out.

BY RUSSELL PEARLMAN

Reprinted and excerpted from the March 2009 issue of SmartMoney. Renaissance Investments had no influence on the editorial content of this article. SmartMoney does not endorse any product or service of Renaissance Investments.

DAVID WINTERS HAS BEEN SPENDING a lot of time in Boca Raton, Fla., lately, but you wouldn't know it—his skin is as pale as it is when he's ensconced in his office in Mountain Lakes, N.J. He's been in the Sunshine State building a new office for his Wintergreen fund, a backup in case the computers, phone lines and Internet connections fail in New Jersey. Winters's Boca office will be "hurricaneproof," housed in an office complex built after Frances and Ivan tore through the state in 2004.

Winters thought he had built a storm-resistant portfolio, too. After successfully running several funds for Franklin Mutual Advisers for half a decade, he created his Wintergreen fund in October 2005. In 2007, Wintergreen trounced the broader market, up 21 percent versus a 6 percent gain for the Standard & Poor's 500 index. By last June, Winters had turned conservative, selling financial-industry stocks and putting nearly a quarter of the fund's assets in cash. But the stock market still blew the roof off the Wintergreen fund, which lost 39 percent in 2008 alone and, at one point, nearly half its value. According to Morningstar, the average stock fund also fell 39 percent last year, though value funds like Winters's did slightly better. "It's Chicken Little this time," says Winters, who often uses children's tales to describe investing climates. "People who are normally quite rational believed the world was going to stop."

Throughout his 24-year career, the 46-year-old has invested in distressed stocks and bonds, eventually seeing many of them skyrocket. But this time he's buying mostly quality, low-debt companies, at the lowest valuations he's ever seen. It hasn't worked yet. As Winters stepped up his buying for the \$942 million fund this fall, even seemingly high-quality firms fell further out of favor. Winters bought Berkshire Hathaway in early October, only to see it fall more than 20 percent over four trading days on worries about the health of the insurance giant. The only strategy that did work, Winters says with the benefit of hindsight, was "sell everything."

It's humbling for Winters (and for SMARTMONEY, too, which named him a World's Greatest Investor last August). He's lost money before, though never this much this fast. But Winters is convinced there are plenty of stocks from around the world that are glaringly underpriced. Of course, he also says some of his stocks and the broader market could take another nosedive in 2009. And he won't venture into inexpensive-looking businesses, such as media, an area where he's made money in the past. But Winters says investors with a time frame of three or more years can buy "Cartier at cigar-butt prices." SMARTMONEY visited Winters in not-so-wintery Boca Raton, where



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he reflected on the worst year of his investing career, why he didn't sell some winners, and stocks he hopes will make a killing in 2009 and beyond.

SMARTMONEY: *So what's it like to see your fund cut in half in 14 months?*

DAVID WINTERS: It's not wonderful, that's for sure. Some of the drops in some securities were just stunning. It was one of these times where you had to clench your teeth and recheck the facts. And when you looked around, you saw that everyone you respect was in the same boat. It's not like they were immune to what was going on.

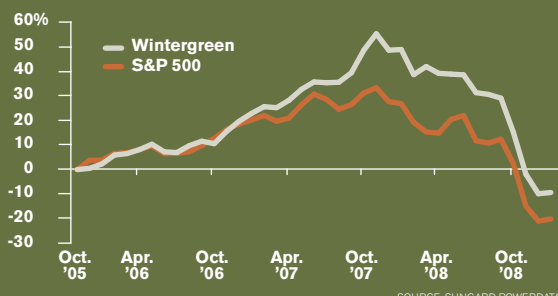
SM: *So did you form a support group?*

DW: We'd see one another at a couple of industry events, like the 75th anniversary of the publication of the book *Security Analysis*. A lot of the serious value players were there, and

David Winters is the portfolio manager of the Renaissance Global Markets Fund.

RISE AND FALL

The Wintergreen fund handily outpaced the broader market in 2007 but was one of many victims of the 2008 crash.



everyone was basically, “Oh, my God, what’s going on?”

SM: *In early 2008 you sensed something was amiss in the market, but you were still down big after that. What happened?*

DW: Almost a year and a quarter ago, we sold almost all of our financials. Then by summer we let cash build and weren’t a buyer. That was something we thought was pretty darn conservative going into a tough period. By June you already had Bear Stearns fail. Could I have predicted in June, when we were down 10 or 12 percent, that in the last six months of the year the world would fall off a cliff? No.

SM: *You were buying stocks on the way down, too?*

DW: In October, when things looked the bleakest, we became a buyer. In retrospect, you didn’t want to buy anything. There was such a demand for liquidity that often the best-quality securities went down. The only thing to have done was to have sold everything. It’s been like nothing I’ve ever seen, and if you weren’t an adult in 1937 or 1932, you’ve never seen anything like this.

SM: *So are you brushing up on the past?*

DW: I actually have reread *Security Analysis*. I hadn’t read it in a while. The Great Depression was rough on [coauthor and famed investor] Ben Graham. But he made it all back and then some.

SM: *How has it been dealing with clients who have seen the fund rapidly lose money?*

DW: We’ve been superfortunate. Knock wood, basically clients have been pretty calm. When you talk to people, they know that this has not been a period of time where there was a great place to hide. I actually

have one guy who calls me and says, “You must be finding a lot of great bargains. You must be having a lot to do.”

SM: *You were sitting on some huge stock gains too. Wynn Resorts, for example, was as high as \$173 a share. It’s \$41 now. Why didn’t you sell?*

DW: Gambling, in the past, has been recession-resistant. But this time it was different because all at once you had higher gas prices, overleveraging, consumers going into a complete stasis, travel restrictions to Macau (China’s gambling hub)—essentially, the perfect storm. It’s so easy in retrospect to say, “Blow out of it, and we’re going to buy it back.” Let’s say we would have sold it. We would have created a capital gain and, most likely, bought the stock back in the \$80s or high \$70s. Would it have made much of a difference? On a tax-adjusted basis, somewhat. But I’ve tried to trade [in and out of] stocks over the years, and it’s extremely difficult to do. The company bought back a lot of stock during the summer at an average cost of \$82 a share, so clearly, they didn’t see it coming either.

SM: *But you still like Wynn?*

DW: We got interested in the casino business because people like going to the tables and the odds overwhelmingly are in favor of the house. I like investing in a business where the house always wins. We studied Steve Wynn’s track record. If you had been an investor in Steve Wynn, you just made a lot of money. He treats the shareholders as he treats himself. The company has a better balance sheet than others. Wynn ends up being the survivor and a big winner of all this. The history has been that Wynn always gains market share in tough times.

SM: *You were a “vulture” investor during the last market mess, investing in really distressed, sometimes bankrupt businesses. Do you have the same strategy this time?*

DW: No. The 2002 vulture period was different because there was a lot of distress, but the world was essentially functioning. And there were actually some really quite good businesses then that were just under distress. If you look at the list of what’s troubled now, a lot of these aren’t great businesses. By the fourth quarter of 2008, you could buy a triple-A company at a really cheap price. We own a series of

securities whose qualities are the highest I have ever seen. We’re going from cigar butts to Cartier because you can buy Cartier at cigar-butt prices. These are “loaded spring” businesses. That doesn’t mean they won’t compress some more. But it will be great if you have a longer time frame—three to five, maybe 10 years.

SM: *So what are some Cartier companies?*

DW: We’ve certainly been a buyer of Berkshire Hathaway. It has a great balance sheet. You can do a sum of Berkshire’s parts

GOING FOR QUALITY

Winters is betting on what he sees as top-notch companies at bargain-basement prices.

COMPANY (TICKER)	PRICE 1/12/09 (\$)
Berkshire Hathaway (BRK.B)	3,139
British American Tobacco (BTI)	55
Goldman Sachs (GS)	78
Nestlé (NSRGY)	36
Wynn Resorts (WYNN)	41

DATA: BLOOMBERG

and see the stock trades at a discount to the parts. They were big buyers of securities and whole businesses in this worst period of time, and they held up no better than anyone else did. As it fell we added, because we think the sun will eventually come up. We think we can make a very handsome return on Berkshire Hathaway over the next two to three years, without a lot of risk. But that doesn't mean it can't fall another 30 percent.

SM: *You're big on food companies too?*

DW: We like Nestlé, a pretty amazing company. You're paying eight or nine times earnings for its food business, and it's growing about 6 to 8 percent organically. People are going to be hungry, and Nestlé has some pricing power. They also have investments in [cosmetics giant] L'Oréal and [eye medical products firm] Alcon. They sold roughly 25 percent of their Alcon stake to Novartis and have this option arrangement to sell the balance of the stake in 2010. Meanwhile, Nestlé is buying back its own stock—an average of a million shares a day, consistently.

SM: *And you are dipping back into the investment banks?*

DW: If we can be a partner at Goldman Sachs and pay roughly book value or below, that's pretty neat. The issues of liquidity, we figure they'll get through it. When this crisis lifts, there is just going to be tremendous amounts of business—an M&A boom and lots of advisory businesses. Goldman Sachs also is a big asset manager. We began to view Goldman Sachs as a loaded spring on a recovery. We've been buying and buying as it's gone down.

SM: *You're not worried that there are any big losses or other financial bombshells with Goldman?*

DW: I don't know exactly. They seem to have been able to sail through. Yes, everyone who has been a realistic participant in the world over the last 12 months has been through a wild storm. They seem to be a survivor, and we think we can make a ton of money with them.

SM: *You've liked tobacco stocks for a long time. Do you still?*

DW: We've added. We do not advocate cigarette smoking, but in a scenario when we don't know what's going to happen, tobacco companies have tremendous pricing power over time. And most of the cigarette companies are oriented toward maximizing their value for shareholders. We like the international companies. We like British American Tobacco very much. It's very shareholder-oriented. They buy back stock. They raise their dividend. They're global. We like Japan Tobacco, too. They are so undervalued, it's wild. Their results have been great, yet the Japanese market has been a very tough place to be.

SM: *What worries you in 2009 or beyond?*

DW: For everyone, the worry is if there really is a depression and the world stops buying everything for some protracted period of time. I think we'll do okay because we own a bunch of businesses that sell chocolate bars and cigarettes and booze. The world will be a lot happier place if we go on with life. But the longer-term issue is inflation. No one wants to talk about it. The governments of all the world will do everything they can to restart the economy. But all this money printed has got to be inflationary. So that's why we're oriented to owning businesses that can generate cash and raise prices. 