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Talking With Anton Schutz

Portfolio Manager Burnham Financial Industries Fund

Changing Streams

By Suzanne McGee

(The following has been excerpted:)

ANTON SCHUTZ LOVES FISHING. ON A good day, when he's lucky, he'll reel in a trophy worthy of display on his office walls, like the seven-foot-long white marlin he hooked while deep-sea fishing. But the hardest catch of all these days isn't fish.

Schutz spends most waking hours trolling the financial markets for stocks that meet his standards for the **Burnham Financial Industries** Fund (ticker: BURFX), the large-cap financial-services mutual fund he has run since its launch in April 2004. The waters he searches remain turbulent, the weather volatile. But Schutz is confident of his ability to land his prey. "They are out there—companies in the financial-services industry that offer stability and upside potential despite all the chaos that surrounds them," he argues. "This is one of those periods that we'll look back on as a once-in-a-lifetime opportunity to have purchased solid institutions at bargain prices."

When Schutz launched the fund, the investment environment was riskier than it is today, because most risks lay beneath the surface. Some warning signs of the bubble in the credit markets and real estate were already apparent to Schutz, who had been managing another fund, the $50 million **Burnham Financial Services** Fund (BURKX), since mid-1999. That earlier fund invested in a lot of small to mid-sized banks (the newer $113 million fund was designed to concentrate on larger names). When Schutz talked to the bankers running those smaller institutions, he heard horror stories about high-risk mortgages being marketed to consumers. He also watched with concern as the Fed began to raise interest rates, and as the amount of subprime mortgage debt being issued and resold in collateralized debt obligations ballooned.

Schutz's new fund was able to sell stocks short, and that's what he did in the run-up to the market meltdown and credit crunch of 2008. "Not many other financial-services funds, or even mutual funds as a whole, were willing to sell short, but I was definitely worried about valuation levels," he says. As a Chase Manhattan banker from the mid-1980s till the mid-1990s, Schutz had become familiar with derivative products, and he also used covered calls to generate income for the fund, both before and during the meltdown. "It's all about finding creative ways to manage risk, and my time at Chase helped me understand that," Schutz says.

When Wachovia bought Golden West Financial—a pioneer in some of the toxic mortgage structures—in 2006, Schutz lost money on his short position in Golden West. "But I made up for it by betting against Wachovia itself," he says. Wells Fargo (WFC) acquired Wachovia's assets for a value equivalent to only $7 a share at the time of the October 2008 transaction.

The combination of careful stock picking, short-selling and hedging helped Schutz deliver a performance that, in the dire market environment of 2008, passed for a home run. While the Standard & Poor's 500-stock average was down 37% and the Dow Jones U.S. Financials Index nose-dived 52% that year, Schutz's fund slid only 7% and quickly recovered. So far this year, it is up 19%, and can point to an average annual gain of 7.7% over the past five years. (The Financial Industries fund has a 2.76% expense ratio.) In that same five-year period, both the KBW Bank Index and the Nasdaq Bank Index posted an average annual loss of 11.4%. By early 2009 he had begun to cover his short positions.

Today's environment is very different from the one in which Schutz established

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	Total Returns* 1-Yr	3-Yr	5-Yr
Financial Industries	19.45	4.48	7.67
KBW Bank Index	–25.96	–25.48	–12.73
NASDAQ Bank Index	–28.06	–19.84	–10.09

Top 10 Holdings	Ticker	% Of Portfolio**
Invesco Mortgage Capital	IVR	9.54%
TFS Financial	TFSL	8.54
Prospect Capital	PSEC	7.07
United Community Banks	UCBI	6.74
PennyMac Mortgage Invest	PMT	5.82
Western Liberty Bancorp	WLBC	5.50
Chimera Investment	CIM	4.94
Bancorp Rhode Island	BARI	4.53
CenterState Bank	CSFL	4.39
1st United Bancorp	FUBC	4.34
Total		61.41

*As of Oct. 31. Three- and 5-year returns are annualized. **As of Sept. 30.
Sources: Bloomberg; Burnham Group

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his credentials. His time at Chase convinced him that the pace of banking consolidation was going to accelerate. When he left Chase, he created an investment firm to profit from that theme. Mendon Capital Management (Schutz's firm, which as subadvisor manages the two Burnham Financial Group funds) began buying stakes in companies that Schutz expected would be targets for acquirers. That play lasted years, helping him deliver hefty returns.

Now it's different. "For most of my career, I've focused on sellers, because that is where the market premium was. Now I am looking at the acquirers, the institutions that are finding tremendous value in picking up broken institutions," Schutz says. "Those are the businesses and the stocks that will generate the greatest returns in the coming years."

He views JPMorgan Chase (JPM) as a winner. The stock, which hovers around $45 a share, could hit 60 to 70 in the medium term, he argues. "The company has been able to earn $4 to $4.50 a share over time," he says; "now that run rate could climb to $6.50," due to its purchasing the assets of Bear Stearns and Washington Mutual at fire-sale prices.

Schutz's portfolio these days is eclectic, ranging from well-known names, like insurance giant Travelers (TRV) and investment bank-turned-"regular"-bank Morgan Stanley (MS), to lesser-knowns, like Invesco Mortgage Capital (IVR) and Chimera Investment (CIM). The last two are specialty finance companies established to invest in distressed real-estate assets, mortgage loans and mortgage-backed securities. "These kinds of new entities will benefit as book values grow; meanwhile, they will be paying out significant yields," Schutz says. The Invesco real estate investment trust is advised by a group including veteran distressed-assets investor Wilbur Ross; Chimera, another REIT, was launched by Annaly Capital Management, which retains a 6.7% stake.

Schutz wants to own banks awash in capital. While that has mostly meant avoiding banks in Florida, California, Nevada and Arizona, one of those he has snapped up is CenterState Bank (CSFL), based in Davenport, Fla. "They have retained a tremendous amount of capital," Schutz says. "They are in the middle of Florida, where there are enough interesting deals to be done at bargain prices that they could double their size, and then some." At about $7.30 a share, the stock is itself a bargain, trading for about half its book value, he adds. Another cash-rich bank is 1st United Bancorp (FUBC), a Boca Raton, Fla.-based lender that raised $70 million in capital in late September: "That is capital that is offensive in nature; they will be using it to buy wounded, sick institutions and that will create value for investors."

Schutz's net has also swept up names like Ameriprise Financial (AMP). He says the money manager trades at prices that don't reflect the value of its assets, which include the Columbia family of mutual funds just purchased from Bank of America. That's a well-known financial firm; Connecticut's People's United Financial (PBCT), however, is anything but. "They were misunderstood by the market. They were a mutually owned savings and loan that has opted to go at least partially public," he explains. Having done so, it is sitting on a lot of capital. He's waiting patiently for People's to make what he thinks will be "a transformative acquisition."

And patience, for investors in financial stocks, is what it's all about. "When you identify the theme that you believe will lead to above-average returns, and you have done your research and identified the companies you think will benefit, then you have to wait for it to come to fruition," Schutz explains. Sort of like landing a marlin. ■

Burnham Financial Industries Fund Class A shares average annualized returns for one-year, three-years, five-years and since inception for the period ended September 30, 2009 are 16.71%, 7.01% 9.40%, and 9.98% respectively. Including the maximum sales charge (5%) and all fees, performance was 10.87%, 5.20%, 8.28% and 8.95%, respectively. The Fund's operating expense ratio gross of fee waivers or expense reimbursements was 2.89% for Class A shares and 3.61% for Class C shares for 2008. Net of dividend expense, the ratios would be 2.76% and 3.47%, respectively.

The performance data quoted represents past performance and is not a guarantee of future results. The investment return and principal value of an investment will fluctuate, so that those shares, when redeemed, may be worth more or less than their original cost. All returns reflect reinvested dividends, but do not reflect the eduction of taxes that an investor would pay on distributions or redemptions. Current performance may be lower or higher than the data quoted due to market volatility.

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Owning mutual fund shares involves investment risk, including possible loss of principal. There are special risks associated with sector funds, which primarily limit their investments to companies in specific industries. This type of fund may be susceptible to factors affecting these industries, and the fund's value may fluctuate more than a fund that invests in a wider range of industries. Because the fund concentrates its investments in one sector of the economy (financial services), and it invests in derivative securities, investors should consider these risks because they may experience greater volatility than in a fund that invests across several sectors. In particular, companies within the financial services sector have recently been subject to unprecedented stock price volatility and depreciation, and there is significant uncertainty regarding the viability and prospects of many financial services companies. Investments in derivatives could magnify any of the fund's gains or losses. Derivatives involve a number of risks, including possible default by the other party to the transaction, illiquidity and, to the extent the manager's view of certain market, security or interest rate movements is incorrect, the risk that the use of derivatives could result in losses greater than if they had not been used.

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The opinions expressed in this commentary are subject to change. Current and future portfolio holdings are subject to risk.

The companies mentioned in this article (in order of appearance) comprised the following percentage of the fund's portfolio as of September 30, 2009. These percentages are subject to change. Please find a list of holdings current to the past month end (plus a 30-day lag) at www.burnhamfunds.com.

Wells Fargo (WFC)	(0.91%)	Chimera Investment (CIM)	4.94%
Citigroup (C)	not held	CenterState Bank	4.39%
JPMorgan Chase (JPM)	not held	1st United Bancorp (FUBC)	4.34%
Travelers (TRV)	3.18%	Ameriprise Financial (AMP)	3.62%
Morgan Stanley (MS)	2.50%	Bank of America (BAC)	3.23%
Invesco Mortgage Capital (IVR)	9.54%	People's United Financial (PBCT)	3.52%

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