


BARRON'S Hedge Funds

A Monthly Report

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Peter Collery, left, and David Hurwitz target deeply undervalued securities that have low intrinsic volatility.

Talking With Peter Collery, David Hurwitz

Co-managers
SC Fundamental Value Fund

Old School Investors

by Eric Uhlfelder

PETER COLLERY IS NO STRANGER TO BUBBLES—AND HOW TO avoid them. When dot-com shares were soaring in 1998 and 1999, his hedge fund, SC Fundamental Value, faltered, despite market-beating returns through most of the decade. As investors chased returns elsewhere, assets collapsed from more than \$600 million to less than \$50 million. “We were investing in profitable, under-valued, low volatility companies while the market was doing exactly the opposite,” recalls Collery.

Collery stuck it out, and the investors who stuck it out with him avoided the dot-com crash, reaping annualized returns of more than 21% in the tough markets from 2000 through 2003.

In 2006, Collery and David Hurwitz, who became partner in 2007, saw signs of a new bubble forming, and the value-oriented fund avoided toxic assets in U.S. housing, banking, and insurance as the markets collapsed in 2008. The fund lost 13.5% that year, a third less than the average hedge fund and far better than the S&P 500's 37% fall.

The firm operates like a family office: Its marketing is nearly nil, and the managers sense that its Graham-and-Dodd classic value investing approach is out of fashion with many investors. Today, SC Fundamental runs just \$84 million; nearly half belongs to the principals and their families.

The names of New York-based SC's alumni may be more familiar to investors. One-time analysts included Greenlight Capital's David Einhorn, SAB Capital's Scott Bommer, and Ivory Capital's Curtis Macenguyen.

Yet the firm's long-term track record is much more consistent than many bigger, better known hedge funds. SC has generated net annualized returns of 12.2% since its founding in June 1990 versus the S&P 500's annual total returns of 9.6% in that *continued on page 32*

What's your investor profile?



☐ *Grabbing, clawing, and gouging with the rest of the gang*

☐ *Out in front, enjoying rarified air*

The Guinness Atkinson Global Innovators Fund is the top performing fund, based on total return, in its Lipper category over all time periods ending December 31, 2014.

GUINNESS ATKINSON GLOBAL INNOVATORS FUND

Lipper Rankings for Global Multi-Cap Growth Equity Category

Time Period (as of 12/31/14)	Rank
One year	1 of 500
Three year	1 of 466
Five year	1 of 399
10 year	1 of 278

GUINNESS ATKINSON
GLOBAL INNOVATORS FUND

Find out more at gafunds.com/innovators

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectus contains this and other important information about the investment company, and it may be obtained by calling 800-915-6566 or visiting gafunds.com. Read it carefully before investing.

Lipper Analytical Services, Inc. is an independent mutual fund research and rating service. Each Lipper average represents a universe of Funds with similar investment objectives. Rankings for the periods shown are based on Fund total returns with dividends and distributions reinvested and do not reflect sales charges. **Performance data quoted represents past performance and does not guarantee future results.**

Investments in foreign securities involve greater volatility, political and economic and currency risks and differences in accounting methods. These risks are greater for emerging markets countries. Non-diversified funds concentrate assets in fewer holdings than diversified funds. Therefore, non-diversified funds are more exposed to individual stock volatility than diversified funds. Investments in derivatives involve risks different from, and in some cases greater than the risks presented by traditional investments. Investments in smaller companies involve greater additional risks such as limited liquidity and greater volatility.

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time. Its annual volatility has been nearly one-third less than the market's, 10.4% versus 14.6%. And its worst drawdown [peak to trough] was 22.2% versus the market's 51%.

Collery and co-founder Gary Siegler (thus the SC moniker) met in the 1980s while working at Dillon Read, where the former worked in leveraged buyouts while the latter was a financial analyst. Hurwitz, a former investment banker at Donaldson, Lufkin, & Jenrette, came on board in 2002. Collery and Hurwitz are about to celebrate SC's 25th anniversary—a rarity in the hedge fund business.

"It also may tell folks something that we're both still married to our first wives," laughs Hurwitz.

SC Fundamental Value was built for the long haul; its investment duration typically ranges between two and five years. Its consistent returns are "a natural byproduct of our long-short positioning," explains Hurwitz, "but also our targeting of deeply undervalued securities that have low intrinsic volatility."

In some ways, SC is an old-school hedge fund, offering investors opportunities in the U.S. and abroad that they're unlikely to be able to tap on their own while delivering consistent returns with moderate risk. These days, the fund has a more international bent, with foreign stocks making up the lion's share of the fund's long positions; of the 80% of capital in long positions, four-fifths are invested internationally. In the past, international stocks have made up as little as 25% of capital. If they don't have the capabilities in-house, the managers will hire local specialists and speakers of the language to facilitate their research.

The managers don't hedge their foreign currency exposure. Over the long-term, hedging currency or not ends up being a wash, performance-wise, they say—a downward currency move, for instance, could initially hurt share price, but eventually make a company's goods and services cheaper, ultimately helping the stock. And they're not interested in capitalizing on, or hedging, short-term swings. Collery and Hurwitz remain focused on their investment thesis.

That thesis is simple—they look for companies that are deeply undervalued—and it begins with a lot of data screening and talking with investors and brokers around the world. Their search for deep value—companies that can return more than 20% a year for at least two to five years—usually leads them to smaller, more easily overlooked stocks. Today the largest market value in the fund is just \$1.2 billion, though its shorts tend to be larger.

SC's managers also, on occasion, offer investors another investment option in an illiquid opportunity, that's separate from the

fund's holdings. Although these "side-pocket" holdings are sometimes derided as a way to separate an investment mistake from the rest of the portfolio, SC doesn't operate this way. It gives investors the option to participate or avoid these ancillary investments. The fund has made just five of these long-term, private-equity-like investments. It's seeded a former employee's new hedge fund,

The managers are finding opportunity in Korea, Singapore, and Europe.

for instance, and made commitments to small, privately held companies. Investors can have as much as 15% of their money in these assets. At the end of 2014, they accounted for about 13% of the fund's assets and are included in its stated returns.

That's not the only unusual aspect of SC, which doesn't lack for courage. In the fall of 2013, for instance, it bought shares of French regional banks affiliated with **Credit Agricole** (ticker: ACA.France)—Europe's second-largest retail bank. **Credit Agricole du Languedoc** (CRLA.France), **Credit Agricole de Normandie-Seine** (CCN.France), and **Caisse Regionale de CA Mutuel Alpes Provence** (CRAP.France). The regionals only trade in France, independent of Credit Agricole. They share significant cross-shareholdings with Credit Agricole, along with some operational and liability risk—but not directly with each other.

"I would expect outsiders to think: Are you crazy?" smiles Hurwitz. But given "ludicrously low valuations and an average yield of 6%," he believed the jurisdictional, regulatory, and linguistic challenges were worth it. Based on the firm's analysis, the regionals are priced at less than 20% of book value. SC put 4.5% of its assets in these positions more than a year ago, which so far have generated total returns of 20%.

SC has also found some opportunity for shareholder activism, particularly in Korea. The firm has another fund that's devoted to activist investing and the managers will bring these ideas into SC Fundamental Value. Before the Korea fund was launched in July 2013, it saw an opportunity with tiny South Korean interior design firm **Kukbo Design** (066620.Korea), back in 2010.

Kukbo was growing quickly, trading at 55% of what its tangible assets were worth, and with a trailing price/earnings ratio of less than 5. Its \$18 million market value was

less than its net cash position. Yet its 2010 revenue of \$117 million was nearly twice its 2005 revenue. The dividend yield was 5%.

"A number of Korean firms remain public for prestige," Collery explains, "when practically speaking, they have no need for additional equity capital or shareholders."

SC joined up with a local Korean investor to buy 14% of the company's outstanding shares. It then won a proxy fight to name a new statutory auditor, whose role is to ensure the firm's board of directors focuses on minority shareholder interests. As a result, the CEO agreed to improve shareholder value via more transparent share buyback programs and increased dividends. Within a year, the stock more than doubled and SC Fundamental exited.

Amid the China-inspired boom in commodities, SC believed the shares of one of Australia's leading mineral-focused engineering groups, **Monadelphous Group** (MND.Australia), had gotten way ahead of its long-term fundamentals, particularly in light of its heavy reliance on customers in the iron ore and coal industries. "The stock's valuation implied Chinese growth would be accelerating," says Collery, "and we believed if Chinese steel consumption simply stabilized, that would have a negative effect on earnings." SC did not think the company's diversification was sufficient to offset declining steel demand.

In late 2012, when MND was trading at five times book value, SC started shorting the shares at an average cost of 18.37 Australian dollars (adjusted for dividends paid). In October, SC covered its position at an average price of A\$12.55.

One of the low notes for SC followed its 2009 purchase of the shares of Houston-based RRI Energy, an independent coal-power energy producer, after they'd fallen to just 20% of replacement cost. "We had just seen only the second year in U.S. history when demand for electricity had fallen," says Hurwitz, "and we thought the stock's \$5 price was excessively beaten down by regional oversupply of power as well." But the rise of fracking and more stringent environmental regulatory limits on coal usage held back the stock. The investment lost 10%.

These days Collery and Hurwitz are likely to spend far more of their money abroad than in the U.S. In particular, the managers are finding the most opportunity in South Korea, Singapore, Malaysia, and Europe. And save for one Australian bank position, the rest of its 40% gross shorts are in the U.S. They decline to specify names.

Hurwitz just doesn't see much value in U.S. stocks right now. Given the fund's history of discerning trouble early on, investors should take note. ■

Bridgewater Bounces Back in January

After a tough 2014, the world's biggest hedge fund group got off to a good start in January as its Pure Alpha Strategy 18% Volatility jumped more than 8% and other strategies also did well.

BEST	% Returns					Assets	
	January	YTD	1-Year	3-Yr Cum.	5-Yr Cum.	(mil)	Strategy
Willowbrook , LP	42.5%	42.5%	38.6%	16.7%	112.7%	2.1	US Long/Short Equity
IW Alternatv SIF-Commod P EUR Acc	35.7	35.7	5.1	N/A	N/A	17.7	Multistrategy
Cambrian Europe Ltd	32.3	32.3	19.8	77.5	95.3	N/A	Long-Only Equity
Kinkopf Capital Management LLC	23.8	23.8	-23.0	-4.4	3.2	0.1	Systematic Futures
IW Alternatv SIF-Real Val Grwth I	23.4	23.4	10.7	N/A	N/A	7.2	Multistrategy
IW Alternatv SIF-Real Val Grwth P	23.4	23.4	10.0	N/A	N/A	5.3	Multistrategy
Estlander & Ptnrs Alpha Trend II P	22.9	22.9	78.6	13.4	20.8	33.3	Systematic Futures
AIS Gold LP	21.3	21.3	-4.5	-73.2	-61.8	7.2	Systematic Futures
Sprott Hedge LP Class F	19.1	19.1	-14.5	-70.7	-64.8	35.3	US Small Cap Lg/Short Eq
RAM LLC	19.1	19.1	6.6	-14.9	13.7	16.0	Systematic Futures
WORST							
Ada Series Total Return LP	-75.0	-75.0	-72.8	-66.9	-60.7	5.4	Multistrategy
Pantera Bitcoin Ltd	-28.9	-28.9	-72.8	N/A	N/A	N/A	Long-Only Other
Lycos Value Class O USD	-26.2	-26.2	-1.9	26.0	93.3	2.3	US Long/Short Equity
New Russian Generation Limited	-23.8	-23.8	-30.4	-76.0	-92.2	91.2	Emerging Mkts Lg-Only Eq
Sustainable Capital Nigeria B	-20.1	-20.1	-40.3	N/A	N/A	N/A	Long-Only Equity
Sustainable Capital Nigeria A	-20.0	-20.0	-42.8	N/A	N/A	N/A	Long-Only Equity
AUK Capital Partners	-19.7	-19.7	-13.0	27.5	120.5	4.9	Event Driven
Lycos Value Class O	-19.1	-19.1	11.9	59.8	129.7	2.3	US Long/Short Equity
The 36 South Cullinan EUR A	-19.1	-19.1	-20.8	-45.5	N/A	N/A	Global Macro
Rivoli Int'l Feeder V9 USD	-18.9	-18.9	-5.5	-8.1	-4.2	2.1	Systematic Futures
BIGGEST							
Bridgewater Pure Alpha Strat 18% Vol	8.3	8.3	12.5	20.4	108.8	30889.7	Global Macro
Millennium International Ltd	2.0	2.0	11.9	35.3	66.6	15806.0	Multistrategy
Bridgewater Pure Alpha Strat 12% Vol	5.5	5.5	8.3	13.4	62.9	9721.0	Global Macro
Bridgewater All Weathr 12% Strat	3.5	3.5	12.4	19.3	79.8	7961.0	Global Macro
Millennium USA LP	2.0	2.0	12.3	36.7	68.9	6855.0	Multistrategy
Renaissance Inst Diversifd Alpha	2.3	2.3	17.3	N/A	N/A	5185.0	Multistrategy
Transtrend DTP - Enhanced Risk (USD)	4.1	4.1	26.4	21.2	33.9	4965.9	Systematic Futures
EnTrust Capital Diversifd Ltd - C	-0.6	-0.6	1.3	18.2	27.8	4674.3	Fund of Fds - Event
Baring Dyn Asset Alloc I GBP	1.5	1.5	7.6	18.1	36.5	2913.9	Multistrategy
UBS (CH) IF Eqs CHE Pass All IX	-6.7	-6.7	5.6	52.8	48.6	2714.6	Long-Only Equity
Bay Resource Ptnrs Offshore Ltd	-0.6	-0.6	8.9	31.2	62.7	2641.0	US Long/Short Equity
MKP Credit Offshore Ltd	0.7	0.7	5.0	39.6	51.4	2514.5	Long/Short Debt
MKP Opportunity Offshore Ltd	3.6	3.6	4.2	15.0	30.5	2478.7	Global Macro
LYNX (BERMUDA) LTD	6.0	6.0	42.2	37.1	66.5	2404.0	Systematic Futures
Pinnacle Natural Resources LP	1.0	1.0	7.4	13.4	26.1	2296.0	Fund of Fds - Macro/Systmtc
CSIMF Swiss Bonds CHF F	2.2	2.2	7.4	8.8	19.2	2059.1	Long-Only Debt
ECF Value IILP	-4.4	-4.4	-3.0	31.7	86.3	1510.3	Event Driven
MKP Opportunity LP	3.6	3.6	4.9	15.7	31.4	1328.3	Global Macro
BlueBay Gbl Multi-Asset Cred H £	0.7	0.7	N/A	N/A	N/A	1302.8	Long/Short Debt
Matignon Derives Credit	0.3	0.3	-1.0	-3.4	-8.6	1292.4	Long/Short Debt

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