



## TIP SHEET: Contrarian Value Runs Contrary To Hedge Fund Herd

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SAN FRANCISCO (Dow Jones)--Not all hedge funds are have fallen on hard times.

Sporting a mix of short positions and long-term holdings in everything from medical-device companies to oil funds, the Contrarian Value Investments fund has posted a slim 1.7% drop for the year through Oct. 31.

If that sounds like faint praise, consider this: the [Standard & Poor's](#) 500, which the fund uses as a benchmark, was off nearly 40% since the beginning of the year on a trailing return basis, as turmoil in global stock and bond markets continues to wipe away value.

The fund's performance validates the investing philosophy of its founder, **Harry Rady**, who runs it out of his La Jolla, Calif. offices. While many hedge funds, particularly so-called quant funds, use computers to pick stocks and make trades, Rady uses programs to identify targets that have good growth prospects and are trading cheaply.

The balance of man and machine is key, Rady says. With thousands of stocks trading all the time, it's impractical to have a human being monitor each one. Rady uses the computer to sift through mountains of data to find companies worthy of more-focused analysis. He says few other fund managers bring that level of detail to their work, relegating many of the decisions to the machine.

"Hedge funds based on pure quantitative analysis can't survive over a long time," Rady said in a recent interview. "I just want my model to do the sifting for me, not the thinking." Over the last three years, based on trailing returns - which include dividends and capital gains and losses - the fund has risen 19.1%, compared with a decline of more than 9% by the S&P 500 on the same basis.

Rady opened the fund in 1995 after stints in a host of other professions. Before becoming a fund manager, Rady was a director at [Westcorp Inc.](#), which was once one of the world's largest auto finance providers. Before that, he was a Budweiser beer distributor.

Like other hedge funds, the Contrarian Value Investments fund uses both short positions - the selling of borrowed shares - and long-term holdings in companies Rady thinks will

appreciate in value over time.

To meet Rady's qualifications for a long-term investment, a company's earnings must be growing at a brisk pace. He also favors companies with low or no debt loads and large cash reserves. Rady's short positions are usually in companies with market capitalization of at least \$5 billion and price/earnings ratios of around 15 times.

Rady acknowledges the current environment has been tough, not only for him but for the whole industry. The HFRI Fund Weighted Composite Index, an industry benchmark, has fallen 12% from Sept. 1 through Oct. 31, which is the latest available figure, amid massive redemptions by investors, who withdrew \$40 billion during October alone. Assets under management by hedge funds, as of October, were at two-year lows.

Right now, Rady's portfolio is weighted toward natural gas, health care and food companies. Rady says those sectors will likely do well over the next 12 to 24 months as the recession grinds away at companies dependent on discretionary spending.

The fund's investment decision-making process begins with a list of potential candidates generated by computer. The initial criteria are easy-to-measure and obtainable benchmarks, like proximity to a stock's 52-week high and cash on hand.

After letting the computer assemble a list of candidates, Rady applies the human touch. He crunches many of the numbers himself and contacts people he knows in the industry. He also does things like request annual reports. How those requests are handled can offer a lot of information, he says. If an annual report is sent overnight or is big and glossy, Rady immediately is concerned that a company isn't focused on expenses.

"I've been doing this long enough that I can eyeball a list of stocks, then do all the things only a human being can do," he said.

Of late, he's been investing in [ProShares Ultra Oil & Gas](#) (DIG), an exchange-traded fund. He chose a fund rather than individual energy companies to invest in because so many oil and gas companies were trading at multiple-year lows. "Everything was so cheap, it was showing up on my list," he said. He bought the fund in the low \$20 range, and sees it rising to \$40 or more. "Then I think I'll sell it," he said. The fund is currently trading at around \$27 dollars according to [Morningstar Inc.](#)

[Kinetic Concepts Inc.](#) (KCI) is one of several medical companies he's invested in of late. The San Antonio, Texas-based company, which makes products to treat wounds, has a 90% share in some of its markets and sports annual average profit growth of 15%. Yet its shares have fallen from a high of \$59.63 on Nov. 30, 2007 to a low of \$18.50 on Nov. 21 of this year. "They have a virtual monopoly," he said. "And their valuation is ridiculously low. That's your dream position for a company."

St. Louis-based agriculture giant [Monsanto Co.](#) (MON) is another recent pick. The stock has plunged from \$145.80 in June to a 52-week low of \$63.47, also on Nov. 21. Rady

began buying the stock prior to that date, when it was trading at around \$74 after determining its earnings and sales were growing by about 30% annually and that it is well capitalized. Here's a company, Rady says, whose prospects are underappreciated given the rise in global demand for its products.

"I get to buy an industry leader, who's well capitalized, growing quickly and at prices like this," he said. "This doesn't happen all that often. It's extraordinary."