

9 Great Funds that Invest in Bargain-Priced Stocks

BY NELLIE S. HUANG

With go-go growth stocks posting gaga returns in recent years, it's easy to forget that value stocks—slower-growing companies with shares that are cheap in relation to profits and other key measures—have prevailed over the long term.

Now, however, the bull market is approaching its seventh birthday, and volatility is on the rise. So far this year, Standard & Poor's 500-stock index has been nearly twice as volatile as it was in 2014. And those high-flying, high-growth stocks? Some have experienced stomach-churning dives: Valeant Pharmaceuticals (symbol VRX), the acquisitive drug company, has dropped 71% since it peaked in August. And Micron Technology (MU) has sunk 51% over the past 11 months.

It may be time to seek some shelter in value stocks and the funds that invest in them. This corner of the market hasn't gotten much love lately, which only makes it more attractive in our eyes. Over the past 12 months, the S&P 500 Growth index, which includes the faster-growing, more highly valued companies in the S&P 500, gained 4.8%, while the S&P 500 Value index, which holds the cheaper names in the S&P 500, lost 2.5%. The S&P 500 itself returned 1.3%.

To hone our list of good value funds, we focused on no-load offerings with below-average expense ratios, consistently above-average performance and below-average volatility relative to their peer group.

All returns are as of November 13; three- and five-year returns are annualized.

Great Value Funds Northern Small Cap Value

Expense Ratio: 1.00%
1-Year Return: -1.0%
3-Year Return: 15.1%
5-Year Return: 11.6%

The world of small-company value stocks has been “a little rocky lately,” especially when compared with small growth stocks, says Northern Small Cap Value manager Robert Bergson. Over the past 12 months, the Russell 2000 Value Index lost 4.6%, while its growth counterpart, the Russell 2000 Growth Index, gained 2.3%. Northern Small Cap Value (NOSGX) held up better, losing 1.0% over the past year.

Bergson's secret is a couple of quantitative models that weed out firms in “financial distress,” he says, and home in on reasonably priced, profitable small companies. He starts with the 1,341 stocks in the Russell 2000 Value Index and, using computer screens, ranks the firms on valuation measures, including price-earnings ratio and the ratio of price to book value (assets minus liabilities). Those at the top and the bottom of the valuation ladder get the boot. “If something is priced too good to be true or too bad to be true, it probably is,” Bergson says. He also avoids the smallest firms by market value.

The second model focuses on quality—or low quality, rather. Bergson looks for characteristics in earnings quality and cash flow, and the change in debt levels and profit margins over time, among other things, that are unattractive. “We identify the firms with the lowest-quality stocks, rather than try to find the highest-quality stocks,” says Bergson. “We seek to do better by avoiding the junk.”

The result is a portfolio of a few more than 500 stocks. That's more than double the number of holdings in the typical actively managed small-company fund. But Bergson likes it big. “It gives us, first, a natural way to manage risk and, second, the ability to reduce transaction costs.” Bergson can hold small pieces of a large number of stocks rather than huge chunks of larger companies. The fund has a turnover of 16%, which implies a typical holding period of more than six years. The typical small-company value fund has a 71% turnover ratio, or an average holding period of a bit less than 1.5 years. ■

Northern Funds Small Cap Value Fund

AVERAGE ANNUAL TOTAL RETURNS AS OF 12/31/15				TOTAL ANNUAL OPERATING EXPENSE RATIOS	
1-Year	5-Year	10-Year	Since Inception	Gross	Net
- 4.62%	9.52%	6.88%	9.74%	1.23%	1.01%

Performance quoted represents past performance and does not guarantee future results. Investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than that shown here. Performance data current to the most recent month end is available by calling 800-595-9111.

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All information in this article is as of November 13; three-and five-year returns are annualized.

Other fees and expenses may apply to a continued investment in the fund and are described in the fund's current prospectus.

Equity Risk: Equity securities (stocks) are more volatile and carry more risk than other forms of investments, including investments in high-grade fixed-income securities. The net asset value per share of this Fund will fluctuate as the value of the securities in the portfolio changes.

Small-Cap Risk: Small-capitalization funds typically carry additional risks since smaller companies generally have a higher risk of failure. Their stocks are subject to a greater degree of volatility, trade in lower volume and may be less liquid.

Value Risk: Value-based investments are subject to the risk that the broad market may not recognize their intrinsic value.

This reprint is not intended as a recommendation to buy, hold or sell securities issued by the companies mentioned in the article.

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