Causeway International Value Instl CIVIX

This fund has the capacity to handle inflows.

5-14-14 | by Kevin McDevitt, CFA

Causeway International Value can handle its increased popularity.

After toiling in relative obscurity for years, this fund has finally been discovered. It has collected an estimated $4 billion over the past 18 months through April 2014. Even though it has been generating consistently strong returns for years, the fund actually had $450 million in outflows overall during the prior 8.5 years. Investors have naturally been drawn to the fund's 9.5% annualized return since its 2001 inception, which is among the 10 best showings for foreign large-blend funds during that stretch.

A surge of inflows can be concerning, but the fund is below its capacity threshold for now. True, the strategy's overall assets hit $21.7 billion in March 2014 including this fund's $6 billion asset base and separate accounts. Comanager Sarah Ketterer estimates the strategy could safely handle up to $35 billion.

That may sound like a self-serving ceiling, but it's backed up by the fund's approach. Management sticks to the most liquid parts of the international equity market. The portfolio is almost entirely in highly liquid large- and giant-cap stocks. They claim 93% of the portfolio, giving it a $40.3 billion average market cap, which is slightly greater than that of the MSCI EAFE Index. Plus, the fund invests exclusively in developed markets, thereby avoiding emerging-markets stocks, which are prone to liquidity squeezes. That has been true during shocks and was evident to a lesser extent in mid-2013 when the tapering of Fed bond buying led to an emerging-markets sell-off and the MSCI Emerging Markets Index fell 7.5%. Sidestepping that dip helped the fund beat 96% of its peers through April with an 18.7% return.

Shareholders should be further reassured by the fact that management has shown discretion in the past. They closed the fund in February 2005 after inflows had spiked and then reopened the fund in January 2008. Although asset growth bears monitoring, this gives comfort that management will turn off the spigot should inflows continue.

Process Pillar: ⊕ Positive | Kevin McDevitt, CFA 05/14/2014

Even though it doesn't buy emerging-markets or small-cap stocks, this fund's above-average Morningstar Risk ratings are not a fluke. That's because the fund's lead managers, Sarah Ketterer and Harry Hartford, often favor companies that are in the midst of a short-term crisis or transition. For example, the team bought Toyota and Transocean in the first half of 2010 when both companies were immersed in negative headlines but had the financial resources to weather the storm. They offset such risks somewhat through price discipline, insisting on strong balance sheets, and by carefully calibrating a stock's historical volatility relative to its prospective returns.

Ketterer and Hartford are more contrarian than value-oriented, as they're willing to embrace companies in turmoil. Although they have minimized blowups, such forays don't always work out. They added to Allied Irish Bank, Unicredit, and UBS just before the credit crisis reached its nadir. But they've also made a number of strong picks following this formula. They boldly added to materials and industrials stocks in the second half of 2008, which paid off in 2009 and 2010. On the other hand, they don't simply buy where prices have dropped either. Unlike a number of peers, the team didn't rush to buy Japanese shares after the earthquake in March 2011. Meanwhile, they usually keep the fund's currency exposure unhedged and turnover below average.

Morningstar's Take CIVIX

Morningstar Rating	★★★★
Morningstar Analyst Rating	Gold
Morningstar Pillars	
Process	⊕ Positive
Performance	⊕ Positive
People	⊕ Positive
Parent	⊕ Positive
Price	⊖ Negative

Role in Portfolio

This is an excellent core foreign-stock holding. Be aware, though, that it sticks to countries in the MSCI EAFE Index, so emerging markets are not well represented.

Fund Performance CIVIX

Year	Total Return (%)	+/–Category
2013	24.17	4.73
2012	24.52	6.23
2011	-10.59	3.37
2010	12.29	2.05

Data through 12-31-13

This portfolio carries a fair amount of cyclical exposure, which has driven the fund's returns but also creates some risks. The team added to cyclical names in the 2008 credit crisis, particularly in the materials and industrials sectors. In contrast, many peers then retreated to less-economically sensitive consumer staples and health-care issues. Over the past five years, the fund's materials stake has increased to nearly 11%, one of the category's larger weightings. Rather than moving into mining stocks, it has favored packaging or industrial chemicals firms such as top-holding Akzo Nobel. Overall, the fund has nearly half its assets in cyclical energy, materials, industrials, and consumer discretionary stocks versus less than 40% for the MSCI EAFE Index.

The team's growing risk aversion has led it to reduce some of this cyclical exposure. The 14% industrials stake has been cut from nearly 24% in late 2011. Because the fund is fully invested as a

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matter of policy, it has moved into less-volatile stocks rather than into cash. It has also sold profitable positions such as Rolls-Royce. There are fewer deeply contrarian holdings, too. With equity valuations up across the board, there are fewer such opportunities. The team has added to European banks—a sector they'd previously shunned—such as BNP Paribas and Lloyds Banking Group because of improved capital positions. But financials remain just 20.9% of the portfolio, well below EAFE's 25.8%.

Performance Pillar: Positive | Kevin McDevitt, CFA 05/14/2014

The fund strives for year-to-year consistency, and it has delivered. It has landed in the category's bottom quartile only once in 11 calendar years. The fund's returns since its 2001 inception are in the foreign large-blend category's top decile, too, despite the fact that it doesn't really buy emerging-markets or small-cap stocks. That has hurt the fund at times. In relative terms, it has struggled the most when emerging markets have outperformed by the greatest margin, particularly 2005-07. What sets the fund apart, though, is that it has occasionally outperformed even when facing this headwind. That was the case in 2003, 2009, and 2010. This is evidence of the team's strong stock-picking.

After a decade or so of small-cap outperformance, the fund is well-positioned for when relative sentiment returns to large-cap stocks. The fund's contrarian strategy has led to above-average Morningstar Risk ratings as well. Its economically sensitive holdings got crushed in 2011's third quarter. The fund's 22% loss that quarter trailed 76% of its peers. That said, management has generally done a decent job mitigating risk. The fund held up slightly better than the category average during the bear markets in both 2002 and 2008 despite holding little cash. Considering that the fund stays fully invested as a matter of policy, its volatility has been reasonable.

People Pillar: Positive | Kevin McDevitt, CFA 05/14/2014

Lead managers Sarah Ketterer and Harry Hartford have been together for nearly two decades, having enjoyed success here and previously with Hotchkis & Wiley, where they managed Hotchkis & Wiley International. Both were with Hotchkis & Wiley when Merrill Lynch purchased the firm in 1996, but when Merrill restructured the organization five years later, Ketterer and Hartford struck out on their own, founding Causeway in June 2001. Current comanagers James Doyle, Kevin Durkin, and Jonathan Eng followed; they've been with Ketterer and Hartford since 1997.

Conor Muldoon, who became a comanager on the fund in late 2010, joined Causeway eight years ago. Foster Corwith and Alessandro Valentini, who had joined the firm in July 2006, were named comanagers in April 2013, bringing the total number of comanagers to eight.

The eight managers are part of a robust research team, which includes seven other fundamental analysts and three quantitative specialists. Each of the managers is responsible for covering individual industries, too. The team aims to have two people cover each company in the portfolio in order to avoid being overly influenced by one person's biases. The fact that the firm is employee-owned has helped tremendously with retention. Six of the managers own shares in the fund, with Ketterer maintaining a position worth more than $1 million.

Parent Pillar: Positive | Kevin McDevitt, CFA 11/15/2013

This 100% employee-owned firm has a strong investment culture. It has been more than 10 years since the principals' 2001 departure from Hotchkis & Wiley, a former Merrill Lynch subsidiary. Causeway has done a nice job of retaining talent. In the case of managers Sarah Ketterer and Harry Hartford, that's because they own most of the firm. But most of the other comanagers also have been at Causeway since the firm's founding.

The majority of the firm's investment professionals have some equity ownership in the firm, and manager ownership of fund shares is strong. About 90% of the firm's mutual fund assets are in funds in which at least one manager has more than $1 million invested.

The fund's board, which is led by an independent chairman, needs to do a better job negotiating reasonable fees on behalf of fund shareholders. Most share classes get Morningstar Fee Level ratings of Above Average or High. To be sure, the board could lower fees further.

One risk here is Ketterer and Hartford being stretched too thin; although the portfolio-management team has increased to eight managers from five, the firm has also increased its mandates. It introduced a long-short global absolute return fund in January 2011, for example. While Causeway's number of strategy offerings are limited and focused on its value philosophy, such alternative funds have been trendy in recent years.

Price Pillar: Negative | Kevin McDevitt, CFA 05/14/2014

The 1.20% expense ratio for this fund's no-load share class is currently 9 basis points (or 0.09 percentage points) above the median for no-load foreign large-blend funds. Below-average turnover helps keep trading costs down. The fund's 2013 commissions were just 0.07% of average total net assets versus 0.12% for the foreign large-blend norm. Nevertheless, its overall Morningstar Fee Level is Above Average. The fund's 2% redemption charge on shares held less than 60 days helps keep short-term traders away.

As of 3/31/14, the Causeway International Value Fund Institutional Class returned 0.06% (QTD), 22.57% (one-year), 9.30% (three-year), 19.50% (five-year), 7.48% (ten-year) and 9.47% (since inception). Inception is 10/26/01.

Performance greater than one year is annualized. The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth less than their original cost and current performance may be lower than the performance quoted. For performance as of the most recent month-end, please call 1-866-947-7000. Investment performance may reflect contractual fee waivers. In the absence of such fee waivers, total return would be reduced. Investor Class shares charge up to a 0.25% annual shareholder service fee. Total returns assume reinvestment of dividends and capital gains distributions at net asset value when paid. A 2% redemption fee applies to shares redeemed. Your performance will be lower if a redemption fee is applied to your account.

Mutual fund investing involves risk, including possible loss of principal. In addition to the normal risks associated with equity investing, international investing may involve risk of capital loss from unfavorable fluctuations in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Current and future holdings are subject to risk. There is no guarantee that securities mentioned will remain in or out of the Fund. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding the funds or any stock in particular, nor should it be construed as a recommendation to purchase or sell a security in any specific nation.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating™ based on a Morningstar Risk- Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating™ for a fund is derived from a weighted average of the performance figures associated with its three-, five- and 10-year (if applicable) Morningstar Rating metrics.

To determine if a Fund is an appropriate investment for you, carefully consider the Fund's investment objectives, risk factors, charges and expenses before investing. This and other information can be found in the Fund's prospectus, which may be viewed and downloaded by clicking http://www.causewayfunds.com/RequestLiterature.aspx or by calling 1-866-947-7000. Read it carefully before investing.

Causeway International Value Fund-Institutional Class (CIVIX) was rated against 701 (three years ended 3/31/14); 625 (five years ended 3/31/14); 332 (ten years ended 3/31/14) Foreign Large Blend funds and received a Morningstar rating of 4 stars for the three year period and 5 stars for the five period and 3 stars for the ten year period. CIVIX was ranked 49 out of 701, 27 out of 625 and 82 out of 332 Foreign Blend Funds for the 3, 5 and 10 year periods ended 3/31/14. The Morningstar Rating is for the Causeway

International Value Fund’s-Institutional Class only; other classes may have different performance characteristics. Fund performance reflects contractual fee waivers. In the absence of such fee waivers, total return would be reduced.

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