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Research and recommendations for the serious fund investor

Where to Invest in 2015 and Beyond

It was a good year for the markets and the economy. Third quarter 2014 gross domestic product grew by 5%, a tremendous number that hasn't been seen in a decade, and the S&P 500 gained 13.7% on the year. Yet we are looking at some uncertainty as oil prices plummeted dramatically in the final months of 2014. The ripple effects are just starting to show up, and I wouldn't be surprised if they continue through the new year.

The oil news creates uncertainty, although there are obvious winners such as the economies of the United States, Europe, and Asia. Industries that are oil- and gas-dependent are going to enjoy a tailwind. That includes airlines, automakers, and even retailers like **Wal-Mart** WMT that need shoppers to drive that extra mile. The obvious losers are energy companies, natural-resources plays, Russia, Venezuela, Iran, and junk bonds.

The big question is how much the troubles of the obvious losers will spread to the rest of the world. The collapse of the ruble has experts harkening back to 1998, when a ruble crisis triggered a sharp decline in emerging markets throughout the world. Outside of energy, Russia's economic ties with the rest of the world are fairly limited, but the situation bears watching. We'll also watch the junk-bond market closely, as oil and gas companies make up a sizable chunk of that market. Could problems there spur redemptions in high-yield funds and, in turn, a broader sell-off in high-yield debt?

Although they may come at the cost of some unpredictable risks of cheap oil, there are some attractive opportunities out there. Let's have a look.

Where Do We Stand?

Stepping back, you can see that we still haven't given back much of the past five years' gains. U.S. equity funds boast robust double-digit annualized five-year returns, and bond funds have healthy single-digit annualized five-year returns.

But the pain is greater on the periphery. Most commodity and precious-metals categories are in the red for the trailing five years. The commodities broad basket Morningstar Category is down about 5% annualized for the past five years, and equity precious metals is down 14% annualized. The risk may outweigh the opportunity at this point.

More intriguing to me is the emerging-markets category, where the trailing five-year return is a mere 1% annualized despite pretty good growth in many emerging-markets economies. And even broad foreign-equity funds have produced gains that are just in line with intermediate bonds over the past five years. Losses in the U.S. small-cap and high-yield markets may spell opportunity as well. But those seeking safer bets will also find recommendations below. These are definitely long-haul picks as some involve quite a bit of short-term risk, so please only use these in places where you can tolerate short-term losses.

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Top Ideas for 2015 and Beyond	Ticker	Morningstar Analyst Rating	Prospectus Net Expense Ratio %	10-Year Total Return %	10-Year Percentile Rank	15-Year Total Return %	15-Year Percentile Rank	Highest Manager Ownership Level
American Century Equity Income	TWEIX	Silver	0.93	7.08	38	8.88	3	$100k–$500k
Artisan International Investor	ARTIX	Silver	1.20	7.13	7	4.43	18	>$1M
Causeway International Value	CIVVX	Gold	1.20	4.80	36			>$1M
DFA US Micro Cap	DFSCX	Gold	0.52	8.05	44	9.90	39	$50k–$100k
Fidelity High Income	SPHIX	Gold	0.72	7.06	19	5.76	69	>$1M
Fidelity New Markets Income	FNMIX	Silver	0.86	8.12	13	10.37	28	$50k–$100k
FPA Crescent	FPACX	Gold	1.23	8.50	3	10.83	1	>$1M
Harding Loevner Emerging Markets Advisor	HLEMX	Silver	1.46	9.19	13	9.38	12	$50k–$100k
Matthews Asian Growth & Inc Investor	MACSX	Silver	1.08	8.90	65	11.41	1	$100k–$500k
Perkins Small Cap Value	JSCVX	Silver	0.83	8.99	17	10.93	41	>$1M
T. Rowe Price International Discovery	PRIDX	Bronze	1.23	9.19	11	6.73	28	$100k–$500k

Data as of 12/31/2014. These are well-run funds in areas that could outperform. As you can see from long-term returns, they're all proven winners. Although Fidelity High Income's 15-year record is unimpressive, Fred Hoff has produced solid performance since cleaning up the very aggressive portfolio left by his predecessor.

Emerging Markets

Some emerging markets, particularly those in Asia, will be big beneficiaries from falling oil prices. That doesn't ensure these markets won't sell off in sympathy with Russia, but it should make them a rewarding place to invest over the longer term, given that share prices have gotten cheap.

Matthews Asian Growth & Income MACSX is one of the best ways to bet on Asia. It's cheap and well-run, and managers Robert Horrocks and Kenneth Lowe are mindful of risk. Buying convertible bonds, corporate bonds, and preferreds helps to take some of the extremes out of investing in Asia. Among common stocks, they look for solid dividend-payers rather than maximum growth.

Harding Loevner Emerging Markets HLEMX offers the whole suite of emerging-markets investing from a seasoned team based in New Jersey. Management seeks high-quality companies with competitive advantages. From comanager Rusty Johnson's start date in 1998 through November 2014, the fund has generated a 13.1% annualized return compared with 9.8% for the peer group.

If the sell-off in emerging-markets debt continues, **Fidelity New Markets Income** FNMIX could make a nice bet on a rebound. John Carlson is hitting his 20-year mark at the fund, and he's proven adept at sorting through the opportunities and hazards in emerging-markets debt. The fund has a cheap price tag to boot.

Foreign Stocks

While the U.S. has come back strong from the meltdown of 2008, Europe remains stuck in the mud. That and the aforementioned challenges in emerging markets explain why foreign funds have lagged U.S. strategies.

That leads me to one value play and two growth funds. On the value front, **Causeway International Value** CIVVX continues to impress. Sarah Ketterer and Harry Hartford have proved to be outstanding stock-pickers, but they are managing only $6 billion at this fund, which has a Morningstar Analyst Rating of Gold. The fund looks for good companies that have hit hard times such as **Toyota** TM and **HSBC** HSBC. Unlike most of its peers, though, the fund is barred from investing in emerging markets.

If Europe isn't growing overall, then seek out those companies that are still growing. That's Mark Yockey's philosophy. At **Artisan International** ARTIX, Yockey blends fast-growers with more-stable growth names to build a diverse portfolio. Over 19 years, he's doubled the category's return without taking an extreme amount of risk. The fund isn't as nimble as Causeway, though, as Yockey runs $28 billion in this strategy.

Small-cap foreign stock had a rough year, so naturally I'm intrigued to see what **T. Rowe Price International Discovery** PRIDX can do over the long haul. Justin Thompson has built a long and excellent record seeking out small-cap companies that produce high returns on investment. The strategy is aggressive enough that you need to have some tolerance for pain (the fund lost 50% in 2008 and gained 55.7% in 2009), but it ought to reward those in it for the long haul.

U.S. Small Caps

Small caps were pricey in the first half of 2014, but they really got smacked in the second half and now aren't so bad. See the "Buy the Unloved" article for my small-cap-growth picks, but here are a couple from the blend and value sides. Micro-caps really got stung, so naturally I'm proposing **DFA US Micro Cap** DFSCX as a comeback candidate. The fund offers cheap exposure to micro-caps, and few active micro-cap funds have been able to keep pace.

Perkins Small Cap Value JSCVX has reopened for the first time in about a decade. Although the fund had strong relative performance in 2014, its weak three- and five-year results have led to an exodus. Yet the longer-term record remains strong, and the fund has rebounded from past slumps quite nicely. Management plies a cautious value-driven strategy that generally unearths some great investments.

High Yield

Keep your favorite high-yield bond fund on your watchlist so you can take advantage of any further sell-offs. **Fidelity High Income** SPHIX is mine. Manager Fred Hoff avoids the more extreme risks that others in the category take on. He doesn't own stocks or really low-rated debt. That's held the fund back a bit, but I prefer more defensive high-yield funds such as this one because every seven years or so, high-yield bonds get taken to the woodshed.

Cautious Funds

While I've shared some relatively speculative ideas, it makes sense to find some cautious funds, particularly among funds investing in the U.S. **FPA Crescent** FPACX, **Vanguard Wellington** VWELX, and **American Century Equity Income** TWEIX provide different ways around that problem. When the next bear market rolls around, you may be glad you own them.

FPA Crescent is a quirky but conservative fund run by Steve Romick. The fund goes anywhere in a company's capital structure depending on where the best risk/reward prospects are, and it will hold large cash stakes when opportunities are scarce. The U.S. has had a strong run, so defensive funds like this have appeal. Assets have grown, and I'd like to see it close, but it has been building staff. More staff means increased capacity, as you can cover more stocks.

American Century Equity Income takes a cautious equity-income strategy and adds on convertible bonds and preferreds to pare risk and boost yield. The fund is a consistent outperformer in down markets—its 20% loss in 2008 was tops in the category.

Vanguard Wellington is a more traditional balanced fund, but it is super cheap and quite well managed. That's tough to beat. The fund keeps two thirds of assets in dividend-paying large-cap value names and one third in a bond portfolio benchmarked to the Barclays U.S. Aggregate Bond Index.

Buy the Unloved 2015

See Page 8 for more investment ideas. M

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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 visiting http://www.causewayfunds.com/ or by calling 1-866-947-7000. Read it carefully before investing.

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