Small Game Hunter

By Peter Staas

A shortage of attractive valuations prompted this fund to keep much of its powder dry at the height of the bull market. Now the manager is on the hunt for bargain-priced small-caps.

With the markets in turmoil, investors have flocked to the relative safety and stability large-cap stocks. That's fine with John Deysher, whose **Pinnacle Value Fund** focuses on securities issued by companies with market caps below $1 billion.

While other investors are lamenting the massive losses suffered in the market implosion, Deysher is remarkably sanguine about the current environment—from the perspective of this value-focused fund manager, the investment climate is finally improving.

Attractive valuations were scarce during the last bull market, prompting Deysher to maintain a cash position in excess of 50 percent for several quarters. But now that the fund's benchmark, the Russell 2000 Index, is down roughly 45 to 50 percent from its highs, Deysher expects to deploy some of this cash.

The prevailing logic suggests that because small-caps generally have limited product lines and resources, this segment is more vulnerable to an economic hiccup. Deysher, however, takes a contrarian view.

But just because a stock is cheap doesn't mean it's worth owning; to avoid "value traps," Deysher follows a disciplined approach to stock selection and reminds investors that, as the fund's largest shareholder, he "eats his own cooking." The fund's bargain-focused manager generally targets four types of stocks: those that trade at a discount to underlying assets; turnaround stories or firms that are recovering from disappointing results; solid, growing companies that the market has overlooked or underpriced; and special situations such as companies emerging from bankruptcy.

In keeping with its focus on long-term growth, the underlying companies typically have a strong balance sheet that will enable them to withstand any headwinds "and survive to prosper another day."

Deysher also prefers companies that have historically produced high rates of return as well as those with substantial insider ownership and capable management teams. Because many of the fund's portfolio holdings fly under Wall Street's radar, the analysts perform their own research and often maintain close contact with each company's board.

Thus far Deysher's strategy has paid off for shareholders. Since its inception in 2003, the fund has generated a return of 8.3 percent, and this year it's trouncing the S&P 500 by more than 20 percent.

What's Pinnacle Value Fund buying these days? Deysher is reluctant to reveal which companies are in his sights—many of his selections tend to trade at lower volumes—but notes that he has a laundry list of securities to pick up once they fall within his buy targets. As of Nov. 30, 2008, however, the fund still held a 58 percent cash position, and the remainder of its investable assets was spread across 32 holdings—less than the fund's average of 40 to 45 stocks. Needless to say, Deysher is biding his time.

Although the fund invests in undervalued stocks across a wide range of sectors, securities issued by financial companies represent 54.9 percent of its portfolio holdings. In some respects, this isn't surprising: This segment has been particularly hard hit over the past year and, as Deysher notes, "When whole sectors come down like that, that's when we become interested."

The fund moved a bit early when it established positions in Chicago-based *Corus Bankshares* and *Preferred Bank,* an institution that caters to Southern California's Korean population.

PINNACLE VALUE

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Sales fee: none **Assets:** $56 million
Early Withdraw: 1.0%, if within first year
No. of Holdings: 32
Turnover rate: 27% **Expense ratio:** 1.5%
Assets in the top 10 holdings: 28.2%
Min. initial investment: $2,500; $1,500 for IRA
Largest quarterly loss*: -7.0%; 2nd Qtr. 2008
Largest quarterly gain*: 7.0%; 2nd Qtr. 2007
Top five positions (symbol): : Preferred Bank (PFBC), MVC Capital (MVC), WHX Corp (WXCO), Argan (AGX), First Acceptance Corp (FAC)

*Past three years. **Source:** *Morningstar*

Both have suffered losses from real estate construction and share prices have dropped accordingly; Deysher has scaled back his position in these holdings a bit, but notes that delinquent loans are declining.

He's more bullish on *Center Financial,* another Korean-focused bank in California, as well as insurance companies, *WESCO Financial Corp* and *Safety Insurance Group.*

The fund maintains a disciplined approach on the sell side as well, a key to protecting capital and locking in gains. Take, for instance, *Conrad Industries,* a shipyard with operations in Texas and Louisiana that builds marine vessels for commercial and government clients. Deysher added the stock a couple years ago after the company changed management and focused on improving its balance sheet. Hurricanes Rita and Katrina were boons to the business; boat orders jumped to replace damaged craft and assist in the cleanup. And when oil and natural gas prices took off last summer, the firm's share prices followed suit, prompting Deysher to reduce his position near the peak.

Although Deysher's canny stock-picking has guided Pinnacle Value Fund to respectable returns in both the near and long term, prospective investors should be aware of certain risks. Not only are small-cap stocks subject to greater price volatility, but the fund also tends to invest heavily in its conviction ideas—28.3 percent of its assets are concentrated in its 10 largest holdings. ▲