FINANCIAL ADVISOR

FA Portfolio Spotlight

John DeGulis

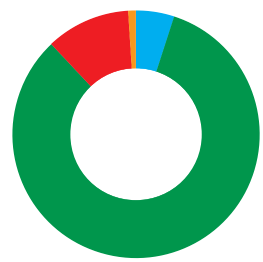
Sound Shore Fund

TICKER	SSHVX
ASSETS	$2.4 billion

PERFORMANCE*	YTD	1 yr.	3 yr.	5 yr.
	1.65%	**5.95%**	**21.04**	**15.66**

As of 7/31/2015. Three- and five-year numbers are annualized. Source: DoubleLine

TOP FIVE HOLDINGS	Merck & Co, Bank of America, CIT Group, Capital One Financial Corporation, Oracle.
CONTACT INFO	800.551.1980 soundshorefund.com



Cash	**4.90%**
U.S. Stock	**83.94%**
Non-U.S. Stock	**11.00%**
Other	**0.15%**

As of 3/31/2015. Source: Morningstar

Thirty Years Of Cultivating Market Wallflowers

That conviction has rewarded investors over the long term. **By Marla Brill**

BACK IN 1993 A MORNINGSTAR ANALYST MADE THE observation that "Sound Shore Fund cultivates the market's wallflowers. This fund is something of a flea market shopper, searching for value that is not reflected in a security's price."

The value-oriented management and investment philosophy remain strikingly similar to when the review was written, when the fund was already eight years old. The original managers, T. Gibbs Kane Jr. and Harry Burn III, still actively participate in day-to-day investment and management decisions. In 2003, John DeGulis, who had been with the firm a decade, made the management duo a trio.

DeGulis, 49, remembers his first years at the fund, when the dot-com bubble was still inflating. "Between 1996 and 1998, the market was up a lot and we did reasonably well," he says. "But in 1998 and 1999, momentum took over and the markets moved away from anything but technology. It was a perfect storm for value investors." The fund, which had risen from virtual obscurity in the mid-1990s to about $2 billion in assets by 1999, shed assets as investors sought greener pastures.

Its fortunes reversed in the early 2000s, when tech-weary investors favored value stocks and performance perked up. "When the broad market was down over 20% in 2000, we were up," he says. "We succeeded because we didn't divert from our philosophy. We did what we had always done."

That conviction has rewarded investors over the long term. The fund's annualized five-year return as of June 30 was 17.06%, above the 15.03% for the average fund in Morningstar's large-cap value category, while the Sound Shore Fund's 7.76% annualized 10-year return bested the Morningstar category's 6.59%. Over the last 20 years, the Sound Shore Fund realized a 10.22% annualized return, while its average peer returned 7.7%.

Today, DeGulis believes the stock market is trading within a fair range relative to interest rates and inflation. "A price-earnings multiple of 16.5 to 17 range for the S&P 500 isn't unusual by historic standards. And history shows the market can sit in mid-teens multiple for a very long time." He also believes the fund's active management offers a better opportunity for outperformance than indexing as the bull market ages and individual stock selection becomes more important. "To beat the index, you cannot be the index," he says. "And we have never been that."

To qualify for inclusion in the portfolio, stocks must be selling cheaply for their historic multiples and lagging the market for what are likely temporary reasons, such as an acquisition that's taking a while to digest or a company's under-recognized financial strength. The portfolio typically holds around 35 to 40 stocks, each of which usually accounts for no more than around 3% of assets. Most of them fall into large-cap territory, although mid-caps are represented as well.

The relative value approach, which compares valuation multiples within a particular industry, has evolved somewhat from the fund's original methodology. "At one time, we focused on the cheapest 20% of the market, based on price-earnings ratios," says DeGulis. "We realized we needed to do a more refined value check by applying measures appropriate to a particular industry."

This more nuanced approach sometimes turns up names that might seem peculiar in a value fund, such as Google. The stock was depressed when the fund initiated the position three years ago because investors were concerned about competition in its core search businesses and how the transition to mobile devices would impact the company. Since then Google has maintained good market share in mobile and has also broadened its reach to other areas of business, such as Android software. The recent addition of a new CFO raises the prospects for a return of capital through dividends or stock buybacks.

Because recovery plays can take years to work out—the typical holding period for a stock is one to three years—investors need patience here. The managers buy stocks looking for at least 30% upside over the next 12 to 24 months but are willing to wait longer if their original premise for investing remains intact. "This isn't a deep-value fund, where we are going to either be big winners or big losers in a short period of time," DeGulis says. "We like investors to have at least a five-to-seven-year time horizon."

He admits that while they don't always get it right, they aren't afraid to get out when things deteriorate. That happened in 2014 when the fund initiated a position in Teradata Corporation, which provides analytic data platforms and consulting services. Unexpected competition sent revenues and the stock down, and the fund sold at a modest loss in that year.

The fund's recent success story stocks include generic drugmaker Hospira, which was added to the portfolio in 2013 when the managers concluded that the earning power of Hospira's leading drugs could double the then-depressed consensus forecasts. The fund sold the position in early 2015 at a 90% gain after the pharma company agreed to be acquired by Pfizer. Aluminum producer Alcoa,

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Valuation And Growth Rates

Price/Prospective Earnings	16.06
Price/Book	1.82
Price/Sales	1.21
Price/Cash Flow	9.19
GROWTH RATES	**%**
Long-Term Earnings	10.24
Historical Earnings	2.79
Sales Growth	0.76
Cash-Flow Growth	-2.39
Book-Value Growth	2.01

As of 3/31/15. SOURCE: Morningstar

Market Capitalization

(As a % of portfolio)

Giant	42.21
Large	35.93
Medium	21.86
Small	0.00
Micro	0.00

As of 3/31/15. SOURCE: Morningstar

Fees And Expenses

Expense Ratio	0.75
Deferred Load	0.00
Minimum Investment	$1M

SOURCE: Morningstar

Sector Weightings

(% of stock portfolio)

Cyclical	
Basic materials	3.83
Consumer cyclical	12.98
Financial services	26.56
Real estate	2.69
Sensitive	
Communications Services	5.47
Energy	3.07
Industrials	3.21
Technology	22.34
Defensive	
Consumer Defensive	2.63
Health care	13.77
Utilities	3.44

As of 3/31/15. SOURCE: Morningstar

Manager
John DeGulis
(with Harry Burn III
and T. Gibbs Kane Jr.)

Age
49

Education
Bachelor's degree, Northwestern University; Master's degree, Columbia Business School

Professional Background
Investment banker, Morgan Stanley; joined Sound Shore Management in 1996 and has co-managed the fund since 2006.

Outside Interests
Playing ice hockey, spending time with four children.

another big winner, joined the portfolio during the second half of 2013, when the stock was selling below book value. It rebounded sharply the following year after management made positive changes, aluminum prices firmed up and consensus earnings forecasts jumped.

Despite a solid long-term track record, the Sound Shore team has no plans to start another fund. "We could certainly manage more money if we wanted to," says DeGulis. "But we like to manage stocks, not people, and we want to manage portfolios, not products." He added that significant investments in the fund by both the management firm's profit-sharing plan and all of the fund's managers provide added incentive to perform well.

Value In Financials, Technology

DeGulis says he's finding the most attractive values now in financial and information technology stocks. Together, the two sectors made up about 47% of the fund's equity assets as of June 30, with financials accounting for 28.4% of the total. On the other hand, the fund's allocation to health-care stocks has fallen from the low 20s a couple of years ago to 13.8% today, mainly because the stocks in the portfolio hit their price targets and the sector has gotten more expensive.

Holdings in the financial group include regional banks as well as larger ones such as Bank of America and Citibank. The fund purchased a number of financial stocks a few years ago well after the businesses had already been recapitalized, and it has added to some of those positions over the years during periods of underperformance. "A number of these banks are restructuring stories," DeGulis says. "They have come a long way over the last year, but their valuations don't reflect that improvement."

Another continuing restructuring story in the portfolio, AIG, is one of the fund's more extreme value plays. The fund initiated that position about three years ago, well after the federal government stepped in and the balance sheet holes had been plugged. DeGulis is impressed by the insurer's stock buyback program, which has reduced outstanding shares by 22% since 2011. Its life insurance arm "is well run and has inherent earning power, and its property and casualty business is returning to health." He expects earnings per share of $5.60 for 2016, up from $3 per share three years ago. Two other insurance companies in the portfolio, Aon and Marsh & McLennan, are brokerage firms that also have large consulting operations. DeGulis likes their business diversity, strong cash flow and low leverage.

Technology holdings in the Sound Shore Fund include Oracle, which became part of the portfolio late in 2014 when the stock was selling at 12 times earnings. Many investors have been concerned that Oracle's transition from on-site enterprise software to cloud-based software for its database management systems will have a negative impact on earnings. DeGulis believes that even though the company is likely to see revenue come in more slowly because of the provisions in the new cloud-based contracts, Oracle's strong industry position and customer relationships will allow it to expand its market and increase sales.

In contrast to the values he's finding in financials and technology, DeGulis believes that investor thirst for high-dividend-paying stocks has made so-called bond proxies such as utilities, consumer staples and health-care stocks look "fair to expensive. None of them is cheap relative to their history." As a result, the fund has modest weightings in those sectors. And while energy stocks have declined over the last 12 to 18 months, concerns about low commodity prices are keeping the fund's allocation to the sector to a modest 2.9%. FA