

MUTUAL FUNDS

Top International Funds Mine Growth, From Europe To India

BY SCOTT STODDARD

The best-performing international stock mutual funds had a hard row to hoe in the past 10 years. Beating the S&P 500 in each of the past one, three, five and 10 years was too tall an order as sluggish economies and heavy debt burdens afflicted regions spanning Asia, Europe and South America. But many funds were able to top the MSCI EAFE stock index, which tracks foreign developed markets, in each of those periods.

The ones that did won the IBD Best Mutual Fund 2016 Award. The award went to 111 international funds out of 411 that have at least \$100 million in asset and that have been around for at least 10 years.

They run the gamut from big-cap to small-cap funds to one dedicated to India. But they all seem to have one thing in common: a focus on well-managed companies able to maintain pricing power, even during the toughest times.

The top five funds have posted 10-year average annual returns ranging from 8.6% to 11.1%, easily beating the 3% return for the EAFE. The period includes the 2008 market crash, during which the major stock indexes lost about half their value, and many individual stocks fell much more than that.

Oppenheimer International Small-Mid Company Fund^{OSMAX}, in addition to beating the EAFE in all four periods, had the second-highest 10-year average annual return among award-winning international funds: 10.80%.

The fund's biggest holdings are Swiss chemicals and biotechnology company Lonza Group; British online supermarket operator Ocado Group; and NICE Systems, an Israel-based company that specializes in telephone voice recording, data security and surveillance. No holding comprises more than 2% of the fund, which has \$6 billion in assets.

The fund looks for "companies doing interesting things, pursuing global ambitions and looking to break out and compete

with large companies," said Rezo Kanovich, who has managed the fund since January 2012.

As an example, he cites Ariake Japan, which has developed a process for deriving meat flavors from byproducts such as bones instead of using artificial flavors, which is typically the case in products such as instant noodles and bullion.

"They're a world leader in this," Kanovich said, adding that Ariake is branching out from Japan in order to pursue further growth in Europe and the U.S.

By contrast, Morgan Stanley Institutional Global Franchise A^{MSFBX} focuses on companies that are already big and international. The largest holding in the \$652 million fund is **Nestle**^{NSRGY}, which accounts for nearly 10% of the portfolio. Next is **British American Tobacco**^{BTI}, followed by **Reckitt Benckiser Group**, **Unilever**^{UL} and **Microsoft**^{MSFT}.

These businesses have growth potential and show resilience in difficult markets.

"Owning companies with steady top-line growth (often due to recurring revenue) and the pricing power to protect margins in tough times meant that the portfolio's earnings continued to rise during the financial crisis, while they halved for the market as a whole," said Bruno Paulson, a London-based portfolio manager with the Morgan Stanley Global Franchise portfolio.

He added that the fund avoids financials, utilities, telecommunications, materials and energy stocks because "they do not meet our requirements for steady growth." On the other hand, he said consumer staples "have been a successful source of companies for the portfolio."

Meanwhile, India may not immediately pop into the minds of U.S. investors looking for consistent long-term growth. But \$1.4 billion Matthews India Fund^{MINDX} boasts a 10-year average annual return of 11.1% — highest among the top 5 — despite the currency, regulatory and other risks that stalk investors in emerging markets.

The fund's top holding is big-cap generic drugmaker **Taro Pharmaceutical**^{TARO}, with about 5% of assets. Other holdings include consumer finance stock Shriram City Union Finance, large-cap business conglomerate ITC Ltd. and tech services company **Cognizant Technology Solutions**^{CTSH}, a stock that has occasionally appeared in the IBD 50.

"Our philosophy of investing in quality stocks for the long term has helped us the most," said Sunil Asnani, the fund's lead manager. "By quality, I mean companies that have a sustainable economic moat and that are run by productive and upright management teams."

In India's context, quality also means that the companies are "masters of their own destiny, and management is in control and not dependent on some policy measures to become favorable," he said.

Asnani said export-dependent industries such as IT outsourcing and pharmaceuticals have benefited from the weak rupee in the past few years. He's also found strong companies in the financial services, consumer and materials sectors.

"Companies that exhibit pricing power and are better governed have done well in an inflationary environment," Asnani said. Inflation in India was 5.7% in January, while the International Monetary Fund has predicted the economy will grow 7.5% this year, among the fastest in the world.

"India remains a secular and buoyant growth story" with a healthy corporate sector and many well-run, entrepreneurial companies, Asnani said. "Investors with a long-term view and an understanding of the risks involved could consider investing in India," he said.

Driehaus International Small Cap Growth Fund^{DRIOX} and Franklin International Small Cap Growth Fund^{FKSCX} round out the five-best performing funds over the past 10 years. However, both are closed to new investors.

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Holdings and fund AUM referenced in this article were sourced from Morningstar as of 09/30/2015 and 03/10/2016, respectively. Please see below for the most recent Top Ten Holdings.

MSIF Global Franchise Portfolio Top Ten Holdings

Security Name	% of Portfolio
Microsoft Corp	8.24
Reckitt Benckiser plc	7.87
British American Tobacco plc	7.60
Nestle S.A.	6.40
Unilever plc	6.01
Altria Group Inc	4.83
Reynolds American Inc	4.83
Accenture plc	4.60
Mondelez International	4.37
Visa Inc	4.11

As of February 29, 2016. Subject to change daily. Provided for informational purposes only and should not be deemed as a recommendation to buy or sell the securities shown above.

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