

## Tilson Focus TILFX

Morningstar's Take | 03-08-2007

by [Michael Breen](#)

### Tilson Focus offers a unique twist on a familiar strategy.

Fans of such successful Graham & Buffett disciples as Bill Miller and Bruce Berkowitz will recognize much in this young fund's strategy. Manager Whitney Tilson is a deep-value investor who seeks firms trading at big discounts to his estimate of their future cash flows. Tilson piles into his best ideas, so the fund typically keeps more than 70% of its assets in its top-10 holdings. Tilson's firm, T2 Partners, has run a similar strategy at its hedge funds since 1999. Tilson says the hedge funds' net-of-fee performance has handily topped the S&P 500 Index's since inception.

Techniques borrowed from the hedge-fund side of its shop set this fund apart. First is its use of options. Unlike its hedge-fund sibling, it won't short stocks or buy put options. But Tilson will amplify long positions with call options when he thinks they offer a more compelling risk/reward profile than the underlying stock. At 20% of assets, the portfolio's stake in call options is higher than any large-blend fund of which we are aware. The fund also employs a performance-based management fee that slides from 1.00% to 1.95% based on the fund's returns relative to the Wilshire 5000 Index.

The fund has roared from the gate. Its 22.7% return for the trailing 12 months is tops in its category. With stock and call option positions, the fund has nearly 30% of assets in Berkshire Hathaway [BRK.B](#) and McDonald's [MCD](#). Both have returned close to 30% over the past year, powering the fund. Of course, this fund's big bets and use of options will multiply the downside, making the fund volatile. Shareholders have gotten a taste of this volatility in recent months, as stock prices have slid lower.

The fund's expense ratio--nearly double the no-load large-cap average--detracts from its appeal. Still, investors who can stomach volatility and embrace this fund's pay-for-performance fees would appear to be in good hands.

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## Morningstar Rating

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### Kudos

Strong stock-picking.

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Managers eat their own cooking: They have substantial ownership stakes in the fund.

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Managers have a proven record running similar strategy at hedge funds.

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Performance-based management fee.

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### Risks

Concentrated portfolio and big bets on individual stocks will court volatility.

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High expenses--even when the lowest performance-based management fee is employed.

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### Strategy

Management targets high-quality businesses whose shares are trading at substantial discounts. They seek to buy dollars for just \$0.50. They emphasize firms with strong cash flows over those with steady earnings. They don't worry about short-term volatility but rather seek to avoid the permanent loss of capital. They run a highly concentrated portfolio, with the top-three holdings typically accounting for more than 35% of assets. They

Year	Total Return (%)	+/- Category
YTD	-0.24	-0.18
2006	25.68	11.48
2005	---	---

Data through 02-28-2007

**Fund Family Score for Domestic Stock: NA**

**Number of Funds Scored: NA**

### Role in Portfolio

Because of its short track record and concentrated style, this fund fits best in a supporting role.

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make tactical use of options, often buying call options to amplify their long positions.

### Management

Managers Whitney Tilson and Glenn Tongue are experienced value investors who have had consistent success in the hedge-fund world. They are principals at this fund and have been with it since inception. Tilson is also chairman and co-Editor-in-Chief of Value Investor Insight.

### Inside Scoop

A highly concentrated stock-picker's fund that makes big bets and uses options. So far, performance has been outstanding. But expect the fund to be very volatile at times. Expenses are also very high.

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