



Causeway Capital's Sarah Ketterer loves to find a bargain – even if that means cheering when an otherwise healthy stock takes a hit



They sent out auto experts to examine the potential damages and legal experts to look at precedents, such as the General Motors ignition switch defect scandal and the Toyota sticky gas pedal recall. After doing their homework, the team not only maintained its confidence in the stock, but went on to buy more.

'Volkswagen went into the crisis with – as Causeway demands – tremendous financial strength, more than €24 billion of net cash on the balance sheet. So that's no net debt, and that's what gave us the confidence to double our weight in the portfolio right after dieselgate,' Ketterer says.

'We looked at what assets the company had: Porsche, Audi and a whole array of commercial vehicle brands. The value of those brands collectively was about equivalent to the company's market cap,' she adds.

'In other words, at the bottom of the crisis for Volkswagen's share price, you were paying nothing for the mass Volkswagen brand. For a value manager, this is the greatest time. We started jumping out of our shoes.'

Making such a call at the depth of the Volkswagen crisis has certainly paid off for Ketterer and the team, as the stock bounced back from a low of €110 per share in September 2015 to €168 per share today.

DO YOUR HOMEWORK

While it's an extreme example, the Volkswagen call sums up much of what Ketterer and Causeway are all about.

They are team-based value investors placing a heavy emphasis on fundamental research coupled with quantitative work, particularly around buying and selling positions. The team's value focus means it

VICKY GE HUANG

Few investors like to see their stocks fall at all, let alone tumbling by 20% twice over the course of two days. Even fewer investors would watch such an event unfold and – in their own words – 'start jumping out of their shoes' for joy.

Still, most investors aren't Sarah Ketterer, portfolio manager and chief executive at \$59 billion value shop Causeway Capital.

The stock in question was German car manufacturer Volkswagen. The cause of the sell-off was the emissions scandal that began in September 2015, when many of Volkswagen's diesel cars were found to feature a piece of software intentionally programmed to detect when they were being tested and to adjust their emissions performance accordingly to meet regulatory demands in the lab.

At the time, Ketterer held the stock in Causeway's flagship strategy, the \$8.7 billion Causeway International Value fund. Rather than joining the many other investors dropping the car firm as quickly as possible, Ketterer and the team slowed things down and took a look in the rear-view mirror.

OUR BELIEF IS THAT COMPANIES THAT HAVE DISAPPOINTED THE MARKET CAN TURN THE CORNER

searches for stocks that have healthy balance sheets but that are trading below what the team deems to be their market value; in effect, those with operational rather than financial troubles.

‘Our belief is that companies that have disappointed the market can turn the corner, can implement operational – not financial, but operational – restructuring; what we call self-help,’ Ketterer says. ‘Time and again, that has proved to be an effective way of finding undervaluation when markets overall are not undervalued.’

‘All the companies that get through our screen have to have an above-average industry financial strength, because we believe it may be a period of time – a year, two years or more – before the company is able to repair or ride the cycle back up again and become in-demand in the marketplace.’

Stocks that pass this test – plus several other screens during the firm’s initial examination – are then subjected to fundamental research. The team meets with management and the company’s customers, suppliers and competitors until it is satisfied with its understanding of the business’s strengths and weaknesses.

Once all of that is in place, the team conducts an internal review of the stock, during which it decides on a two-year price target for the stock, ranks all of the researched stocks for risk-adjusted returns from the highest to the lowest, and then focuses on the highest ranked stocks to construct a portfolio.

SHARED FOCUS

Ketterer believes that this team-based structure and the combination of quantitative and fundamental research has fostered a virtuous cycle where no one person has too much control.

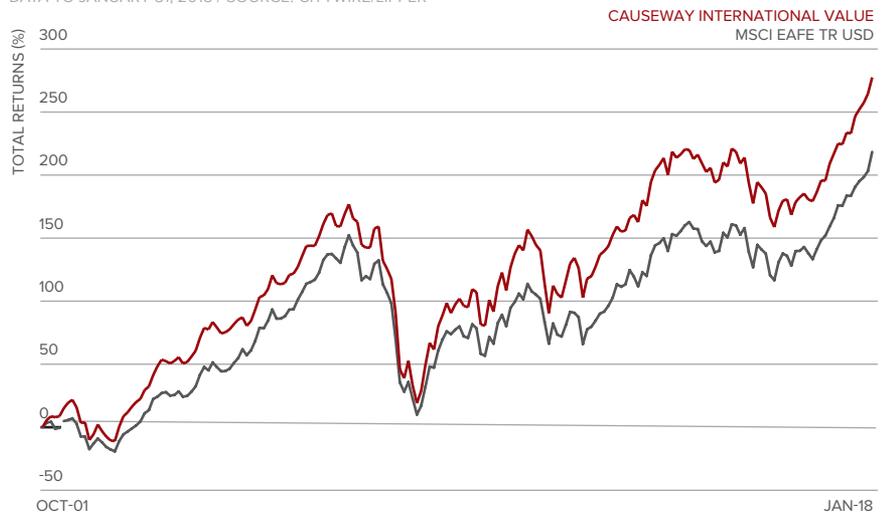
‘There are no egos and there are no one or two people whose biases are permanently embedded in the portfolio. There are times when value may be in financials, or it may be out of financials and in cyclicals, or it may be in healthcare. Wherever value happens to be residing, that’s where we will have an emphasis in our portfolio,’ she says.

‘That collaborative approach helps us avoid myopia, where an individual maybe for several decades in his or her career has been covering the same companies and just doesn’t see the change that’s occurring any longer. Bringing in fresh eyes on the team to critique and question



THE CAUSEWAY INTERNATIONAL VALUE FUND HAS PULLED AHEAD OF THE INDEX

DATA TO JANUARY 31, 2018 / SOURCE: CITYWIRE/LIPPER



the assumptions that we use in the valuation work has always been a really helpful part of the process,' she adds.

'There's also a very significant quant contribution when it comes to the time to exit the stock, because quant is very good at understanding earnings momentum and price momentum, whereas fundamental isn't. Those have to factor into the equation when you buy and when you sell,' she says.

OTHER BIG CALLS

The success of this approach helped the eight-person team behind the Causeway International Value fund earn the title of Morningstar's US International-Stock Fund Manager of the Year for 2017. It also helped when it came to making another key pick,

Chinese state-owned telecommunications firm China Mobile.

'We like China Mobile because of its scale,' Ketterer says. 'Imagine having 890 million customers. Even Amazon can't say that. Because China Mobile is a state-owned enterprise – it's really a state-owned industry – other than having the market rewrite the stock, there would be no acquirer, no raider and no activist, obviously.'

'The market may be concerned that the company's expenditures on 5G will be overwhelming and deleterious to shareholder return. We disagree – we think that the company knows its obligations both to the national buildout of 5G and also to shareholders. Keeping the capital markets satisfied is a really important responsibility if you want to have

access to them in the future,' she adds.

While China Mobile and Volkswagen may seem like risky plays, neither are as risky as the move Ketterer made when she left Hotchkis & Wiley, the value shop co-founded in 1980 by her father, John Hotchkis.

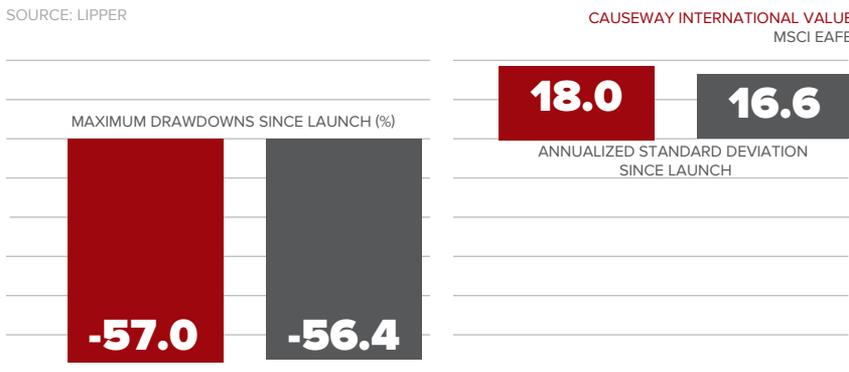
Having left investment banking behind to join the firm, Ketterer was five years into her time at Hotchkis & Wiley when it was sold to Merrill Lynch. She wasn't about to let her work co-building the international equity team go to waste.

'The acquirer was going to buy it all. That company was a growth firm while we were adopting a value approach, so we decided the best way to keep a talented investment team was to form Causeway in 2001,' she says. 'Much to our satisfaction, not only did our former team members follow us, but most of our clients did too.'

Today, the Los Angeles-based firm is still 100% employee-owned. 'It's thrilling to go to work when you own it yourself, when you report to yourself,' Ketterer says. 'It's high-risk but it's also high-reward. And great investors like to pick that type of risk.' ■

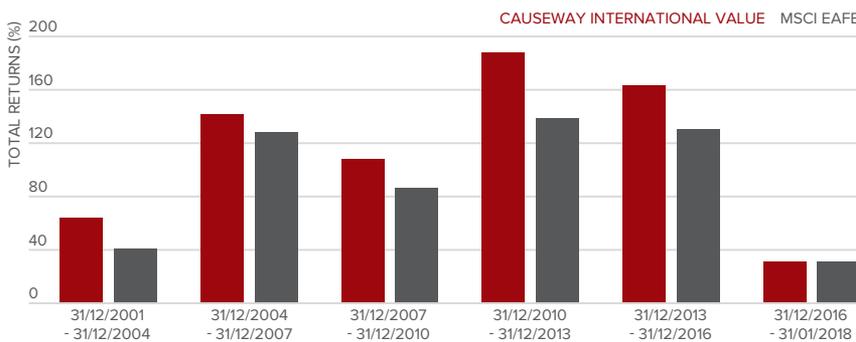
RISK METRICS OF KETTERER'S INTERNATIONAL VALUE FUND VERSUS THE MSCI EAFE INDEX

SOURCE: LIPPER



KETTERER'S FUND HAS LARGELY OUTPERFORMED THE INDEX OVER DISCRETE THREE-YEAR PERIODS

DATA TO JANUARY 31, 2018 / SOURCE: LIPPER



VERDICT



FRANK TALBOT
HEAD OF INVESTMENT RESEARCH, CITYWIRE

International equities have been an extremely popular trade over the past few years as investors seek to diversify away from the expensive domestic equity market. Fortunately, there is an abundance of quality in this peer group.

Since its launch, the Causeway portfolio has been among the very best that investors can access here, and while the fund's returns have been slightly behind the index over the past one and three years, it has historically been extremely consistent.

The key exposure within the fund is toward Europe, and its exposure to the UK and sterling has been good for returns in recent months as the currency continues its recovery from the Brexit shock.

Important Disclosures

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 full or summary 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.

Investing involves risk including loss of principal. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Investments in smaller companies typically exhibit higher volatility. Diversification does not prevent all investment losses. There is no guarantee that risk can be managed successfully or that the fund will achieve its stated objective.

For performance data current to the most recent month end, please call 1-866-947-7000 or visit <https://www.causewaycap.com/fund/international-value-fund/>

Holdings are subject to change and current and future holdings are subject to risk. The top 10 holdings for the Causeway International Value Fund may be viewed by visiting <http://www.causewaycap.com/fund/international-value-fund/>

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