INVESTMENT PRODUCTS

Strategies of the five-star bank funds

Which are the best bank-advised mutual funds? One answer is, "those that have won five stars from Morningstar." Along with total return, Morningstar Inc., the mutual fund research firm based in Chicago, takes into account such factors as loads, fees, and risk—for example, to what degree a fund has underperformed the three-month Treasury bill compared to the other funds in its class. Funds must have at least a three-year track record to get any Morningstar stars.

Only three U.S. commercial banks have five-star funds in Morningstar's categories "growth" and "growth and income": PNC's Compass Capital Value Equity Institutional, Banc One's One Group Large Company Growth, and Riggs National Bank's RIMCo Monument Stock. The managers of these funds have developed their own methods of achieving consistently strong performance with relatively low risk.

Finding value

Earl Gaskins, manager of PNC's Compass Capital Value Equity Fund and vice-president of a funds management branch of PNC called Provident Capital Management, has been managing money for 20 years and has been managing the Compass Capital Value Equity fund for 11 years (the fund has institutional and retail classes).

As the word "value" in its name suggests, this fund invests in companies whose stock is priced lower than normal indications of value—such as earnings, cash flow, book value, and sales—would warrant, and that don't deserve Wall Street's low opinion of them.

Each month, Gaskins screens the entire universe of stocks. First he weeds out those with a market capitalization of less than $800 million. From the stocks remaining, he selects the bottom 40% in price-to-earnings and the lowest 20% in price-to-book, price-to-sales, and price-to-cash-flow, which comes to about 650 names.

He puts these stocks through more quantitative and qualitative analysis. Gaskins follows certain industries closely (particularly those that have a large presence among the value stocks) and he sometimes visits companies to see how they're doing. "There are times when stocks have low valuations for very good reasons," he says. "At one point in this century companies that sold buggy whips were selling at low valuations. There wasn't any reason to think that those companies were going to recover." He would shun a company whose management is falling apart, is unrealistic about its industry, or is burdened with debt, for example. He tends to choose stocks Wall Street hates most, because their prices have already been adjusted to expected negative events, and they are more likely to pleasantly surprise in earnings and outlook. He finally ends up with about 80-85 value stocks with the best prospects.

One stock the fund has made a great

Top U.S. Commercial Bank-Advised Growth and Income Funds

(according to Morningstar's risk-adjusted ratings as of Feb. 27, 1996)

Fund name	Bank advisor	Morningstar rating	Morningstar risk* (3 year)	One year return	Three year annualized return	Net assets (millions)
RIMCo Monument Stock	Riggs National	5	0.59	39.57%	19.50%	$83.00
Kent Index Equity Institutional	Old Kent	4	0.69	37.25	15.38	185.00
Compass Index Equity Institutional	PNC Bank	4	0.69	38.03	15.72	115.40
Kent Index Equity Investment	Old Kent	4	0.69	36.80	15.19	6.60
Evergreen Growth & Income Y	First Union	4	0.68	34.47	16.12	140.50
CoreFund Equity Index A	CoreStates	4	0.69	37.43	15.39	130.50
Compass Index Equity Inv A	PNC Bank	4	0.70	37.53	15.37	8.00
Dreyfus S&P 500 Index	Mellon Bank	4	0.69	37.85	15.63	365.40
Dreyfus Disciplined Stock R	Mellon Bank	4	0.67	39.35	15.45	438.80
Seven Seas S&P 500 Index	State Street	4	0.68	38.23	16.03	532.30

Source: Morningstar, Inc., Chicago

*Morningstar risk is an in-house calculation that determines how much and how often a fund underperforms a particular investment option, such as a Treasury bill, compared to other funds in its class. The average risk rating for each fund class is 1.00. A Morningstar risk rating of 1.35 for a taxable bond fund means that the fund has been 35% riskier than the average taxable bond fund for that period.

By Penny Lunt, senior editor

deal of money on is Boeing. "In 1992 and 1993, the nation's airlines were in the doldrums," Gaskins says. "They were cancelling orders and the Boeing stock fell on very hard times, sinking as low as $35 a share. In speaking with my clients at the time it was obvious that only an idiot would be buying Boeing."

But these difficulties were already reflected in the low price of the stock, and Gaskins watched for the point at which Boeing's orders stopped dropping. "We knew Boeing was a premier aerospace company that was very well managed, that had a huge share of the commercial airline market, and we knew someday new planes would be needed," he says. "They do wear out and there are noise regulations."

Now investors are buying Boeing at 60 times earnings. "They can't get enough of it," Gaskins says. "And we're selling it."

Other stocks that have been good to this fund include United Technologies and Monsanto. The fund usually has large holdings of bank and insurance company stocks, which tend to be undervalued because of the maturity of the industries. Gaskins put a large chunk of the fund in banks in 1990 and 1991, when some were going under and all were very cheap. Those purchases have paid off well over the last five years.

In January of this year, the fund was merged with some other funds and its name was changed—it used to be the PNC Value Fund.

The big picture

At the opposite end of the investment spectrum is Lynn Yturri, manager of the One Group Large Company Growth Fund, who takes a top-down approach. He studies demographic, political, social, and economic trends to determine the most important changes influencing the world and the stock market. Then he analyzes industries to figure out which are growing and which are deteriorating or obsolete, based on the trends he's observed. Then he looks for companies in growth industries that are well-managed and positioned to benefit from the trends.

One theme he has developed is that the youthfulness of developing nations—in many of these countries, 25% of the population is under 10 years old—will provide a huge opportunity for U.S. consumer product companies to sell soft drinks, razor blades, cosmetics, soaps, and detergents. Another theme is consumers' growing concerns about diet, health, safety, and nutrition. "Hershey is introducing some new diet chocolate bars, called Sweet Escapes, because of this theme," Yturri says. "The problem with diet products is that they taste terrible. But I have the feeling that with the know-how of a company like Hershey, they'll come up with one that actually tastes good."

He believes changes in technology will be a driving force in the markets. But while technology stocks did well the past two years, now he feels many are fully priced and the earnings outlook for others is changing. "We've shifted our view away from companies that produce the hardware and toward companies that are technology beneficiaries," Yturri says.

An example is Oil Service, a company that is using advanced technology to explore and develop oil wells more efficiently, he says. Another is Medtronic, which a year ago introduced a new pacemaker called the Jewel. "This product is inserted differently, it saves $10,000 per operation, and there are 80 of these operations in America a day," he says.

He sees health care as a huge growth business, partly because of the aging of the U.S. population—"6,000 people a day reach the age of 65," he notes. "Some of our biggest winners over the last year have been in drug delivery. Forty percent of prescriptions are not complied with either because people can't read the instructions or they forget to follow them. Many people can't swallow or take pills or shots. The future, we believe, is for therapeutic compounds to be administered through patches, so you don't have those problems of forgetfulness or compliance." Three leaders in this area are Alva, Elan, and Theratech.

Yturri also likes the long distance

TOP U.S. COMMERCIAL BANK-ADVISED GROWTH FUNDS

(according to Morningstar's risk-adjusted ratings as of Feb. 27, 1996)

Fund Name	Bank advisor	Morningstar rating	Morningstar risk* (3 year)	One year total return	Three year return	Net assets (millions)
Compass Capital Value Equity Institutional	PNC Bank Corp.	5	0.68	34.99%	16.84%	$532.20
One Group Large Company Growth	Banc One	5	0.53	28.56	16.68	665.00
Kent Growth & Income Investment	Old Kent Bank	4	0.60	33.92	15.38	11.10
Kent Growth & Income Institutional	Old Kent Bank	4	0.60	34.21	15.63	403.30
Evergreen Value Y	First Union	4	0.58	32.26	14.85	759.80
Evergreen Value B	First Union	4	0.60	31.01	13.82	141.00
First American Special Equity A	First Bank, N.A.	4	0.72	20.40	14.42	10.80
Compass Value Equity Investment A	PNC Bank Corp	4	0.71	34.54	16.49	18.50
Victory Ohio Regional Stock	Keycorp	4	0.74	25.01	12.82	40.80
Westcore Midco Growth	First Interstate	4	1.14	28.55	13.75	547.00

SOURCE: Morningstar, Inc., Chicago

*Morningstar risk is an in-house calculation that determines how much and how often a fund underperforms a particular investment option, such as a Treasury bill, compared to other funds in its class. The average risk rating for each fund class is 1.00. A Morningstar risk rating of 1.35 for a taxable bond fund means that the fund has been 35% riskier than the average taxable bond fund for that period.

communications business. "In this country we spent $70 billion on our telephone bills in 1995," he says. "We love to talk." Capital goods and energy companies and conglomerates will also do well going forward, he believes.

Last year the Large Company Growth Fund more than doubled in assets, from $250 million to $740 million. About a third of that was new money that came in through Banc One's brokerage affiliates in 12 states and from its trust departments. Another third came from two other funds that were merged into this fund in 1995, and the last third was due to capital appreciation.

Restructures, new products, mergers

Philip Tasho, chief investment officer at RIMCo, the investment subsidiary of Riggs National Bank, Washington, takes a value momentum approach to managing the bank's RIMCo Monument Stock fund, the only five-star U.S. commercial bank fund in the growth and income category. (The "Monument" name comes from being in Washington.)

Tasho takes large cap stocks that are undervalued and looks for a near-term catalyst that will cause earnings acceleration and earnings surprise. He monitors consensus estimates on Wall Street and ranks stocks one through ten (ten being the worst) based on their potential for earnings improvement. Among the high scorers, he selects those that have the most attractively low valuations. To predict how those stocks will do in the future, he looks for three basic themes.

The first is restructuring. "Usually when companies reach an earnings plateau, the directors get antsy because the shareholders are after them," says Tasho. "They'll pressure the organization to restructure to try to generate better earnings growth." An example is Sears Roebuck and Co. Sears installed new management, focused on merchandising, and divested itself of noncore assets, particularly financial ones. "This has led to earnings acceleration and it was a good value when we bought it initially in 1993, when the company was growing at 20% and the price-to-earnings ratio was nine."

The second theme is a new product story. Companies with new products tend to have better revenue growth and profit margins, which leads to earnings acceleration, he says. An example is Pfizer Pharmaceutical. Pfizer had not come up with many new drugs in the late '80s when other companies had—its new products came out in the early '90s. Now, 40% of the drugs it sells did not exist five years ago.

The third theme is consolidation. Tasho has invested this fund in such consolidating industries as finance, aerospace, and defense. Rockwell International, Wells Fargo, and Columbia HCA are three examples of consolidating companies the fund has invested in.

The RIMCo Monument Stock fund grew from $58.2 million at the end of 1994 to $82.9 million at the end of 1995. ***BJ***