MORNINGSTAR®

Reprinted by permission of Morningstar, Feb. 19, 2013

Sound Shore SSHFX

A payoff for persistence.

2-19-13 | by Gregg Wolper

Sticking with its convictions tends to pay off for Sound Shore Fund, though sometimes it takes a while.

This fund allows a patient approach to play out. It has been around for 27 years, and two of its managers have been at the helm from the start. They own a majority stake in advisor Sound Shore Management and run no other strategies. So, they won't be urged to rethink a stock pick by a corporate overseer if it doesn't provide a rapid reward.

That proved very helpful in recent times. The managers put money into Citigroup C and Bank of America BAC in 2009 and early 2010, which hurt returns for an extended period, especially in 2011, when the fund landed in the bottom quartile of the large-value category. (General Motors GM was a culprit in the latter year, too.) But they held on. In 2012 all three stocks soared, and so did the fund. It gained 19.3% and landed in the top decile. It's not all banks and autos here, though. Early this year, a late-2011 purchase, Life Technologies LIFE, which they'd bought when its price suffered on concerns about acquisitions and government policies, jumped on word it might be open to a takeover bid. That stock is up about 30% for the year to date through Feb. 14, helping the fund get off to a strong start this year.

Managers Harry Burn, Gibbs Kane, and John DeGulis look for large and midsize companies whose future prospects are, in their view, rosier than most investors think. They typically don't own the most downtrodden turnaround candidates—although Bank of America probably struck some as just that. Over the long run, the fund tends to succeed with small victories rather than the more noteworthy swings of the big banks or Life Technologies. It often lands in the category's second quartile. Although its subpar 2011 is now holding its three- and five-year returns to the middling range, over longer periods—10, 15, and the full 27 years—it lands ahead of the category and the S&P 500 Index by moderate margins.

In short, this fund is a known quantity that offers a proven process, if not the likelihood of frequent knockout wins.

Process Pillar: ⊕ Positive

The managers look for stocks that have solid fundamentals and encouraging prospects but that are out of favor for one reason or another. To find candidates, they and their analysts screen mid- and large-cap equities from the United States and abroad to identify stocks trading at substantial discounts to their historic price multiples. Once the team has narrowed the list, it evaluates a firm's competitive position by speaking with company management, competitors, and customers. The team then prepares detailed financial and valuation models. The result is a portfolio of 40 or so mid- and large-cap companies. Even with such a compact portfolio, though, the fund is not overly concentrated in individual companies, as many focused funds are; typically no stock gets more than 4% of assets. The managers' willingness to buy companies about which most investors have doubts means the fund's stocks sometimes fall further before their value is recognized and sometimes don't recover. While foreign stocks often appear in the portfolio, their number usually is limited to a handful of names; this is over whelmingly a fund of U.S.-based companies. The managers have a long-term perspective but will sell when a stock appreciates to their target price or the story changes for the worse, so the annual turnover rate, though lower than the large-value average of nearly 80%, has rested in the 60% range in recent years rather than at more-minimal levels.

The fund's most recent portfolio looks similar to previous ones. That isn't surprising, for despite a turnover rate of about 60% in recent years—which, while lower than the category norm, means trading isn't rare—the managers tend to hold on to what they own for several years, with trading often consisting of trimming back winners so they won't take up too large a portion of the portfolio. (The latest portfolio is typical in being small overall, holding about only 40 stocks, but with the top holdings getting only 3% of assets apiece.) In the top 10, the fund still owns several Big Pharma names it has favored for years, including Novartis NVS and Pfizer PFE; they bought these firms when doubts about their pipelines and other concerns hit their valuations, and they still consider them attractively priced, given their willingness to consider splitting into several parts to add value. Big banks that the

Morningstar's Take SSHFX

Morningstar Rating	★★★
Morningstar Analyst Rating	Silver
Morningstar Pillars	
Process	⊕ Positive
Performance	⊕ Positive
People	⊕ Positive
Parent	⊕ Positive
Price	⊙ Neutral
Role in Portfolio	
Core	

Fund Performance SSHFX

Year	Total Return (%)	+/–Category
2012	19.32	4.75
2011	-6.18	-5.43
2010	12.13	-1.53
2009	26.64	2.51

Data through 12-31-12

managers also bought when deeply out of favor, notably Bank of America BAC and Citigroup C, also remain prominent in the portfolio. But a new name, Google GOOG, appeared in mid-2012; the managers explain that they like its dominant position in search. They think it has made progress in figuring out how to profit adequately from mobile-phone ads and will continue to meet that challenge. Overall, though, the portfolio has less of its assets in the giants than most large-value funds do, so its average market ap of about $33 billion is well below the group's average.

Performance Pillar: ⊕ Positive | Gregg Wolper 02/08/2013

This fund's long-term performance is decent to solid. Its 10-year ranking through Feb. 7, 2013, is in the 25th percentile of the large-value category, and for the 15-year period it lands in the 35th percentile. And with this fund, long term really means long term. From the fund's inception in 1985 through Feb. 7 (with two of the three current managers in charge the whole time), it has posted an annualized return of 10.8% per year, topping the S&P 500 Index by nearly half a percentage point and the large-value and large-blend indexes by more than 1.5 points apiece (its portfolio has spent some time in both sections of the Morningstar Style Box). The fund suffered through two subpar years in 2010 and 2011, with the likes of Citigroup C, Bank of America BAC, and General Motors GM holding it back, but sticking with them paid off as the fund rebounded in 2012. Its 19.3% gain for that year topped the large-value category average by nearly 5 percentage points and the S&P 500 Index by more than 3.

Investors should not choose this fund for a smooth ride, however. True, in the brutal bear market from early October 2007 to early March 2009, the fund's 52% loss was 3 percentage points less than the loss suffered by the S&P 500 Index and nearly 5 points less than the large-value category's. But its Morningstar Risk ratings and other measures of volatility over time aren't much better, and in some cases are worse, than the norm.

People Pillar: ⊕ Positive

Shareholders here get an extraordinary amount of experience and continuity. The managers of Sound Shore have been guiding this fund, using the same strategy, for decades. Managers Harry Burn and Gibbs Kane founded advisor Sound Shore Management in 1978 (Burn has a 45% ownership stake, Kane 30%), and they have led Sound Shore Fund since its inception in May 1985. (The private accounts run by the advisor, which amounted to 54% of the firm's $4.7 billion of assets under management at year-end 2012, use the same approach as the fund; the firm does not run any other strategies.) Burn and Kane were the mutual fund's sole managers until 2003, when John DeGulis, who had worked with them as an analyst since 1995, was named a comanager of the fund. Burn, Kane, and DeGulis all have more than $1 million of their own money invested in Sound Shore, a commitment that helps align their interests with the fund's shareholders as much as possible. (The firm's profit-sharing plan also is invested in the fund.) This trio works with four in-house analysts who joined the team between 2003 and 2008, and all are based in heir office in Connecticut. Most stocks are researched by teams of two, typically one manager and one analyst. The firm does little to no marketing of the fund and has come out with no other mutual funds.

Parent Pillar: ⊕ Positive | Gregg Wolper 10/03/2011

This firm has some attributes that many other fund companies would be wise to emulate, in part if not in whole. Sound Shore Management was founded in 1978 by Harry Burn and Gibbs Kane, two of the portfolio managers of Sound Shore SSHFX, and it is still owned and run by them. The firm offers just one mutual fund, and its only other business is running separate accounts in the same style. The firm doesn't do any advertising and does very little marketing. The fund managers spend only minimal time on any sort of marketing activity.

The firm had $5.2 billion under management as of Sept. 30, 2011, with slightly more than half of that in separate accounts. Its managers and analysts stick around; there has been no manager turnover—Burn, Kane, and John DeGulis, who has been with the firm since the 1990s, are the three managers—and little change among the analyst staff, which now numbers four. The three managers each invest more than $1 million in fund shares, demonstrating industry-leading skin in the game.

The one area that could stand improvement is shareholder communications. Shareholder reports are candid about specific holdings, but they are not as lengthy or detailed as they could be, especially when compared with the best reports from small shops committed to a distinctive style, such as Third Avenue.

Price Pillar: ⊙ Neutral

Sound Shore Fund has only one share class, which has no load attached to it. Its expense ratio of 0.94% in 2011 (which rose just 1 basis point to 0.95% in the first half of 2012) is in the average range for large-cap domestic-stock funds with no sales charge, so the fund gets a Neutral rating for Price.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating TM based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating for a fund is derived from a weighted-average of the performance figures associated with its three-, five- and ten-year (if applicable) Morningstar Rating metrics. Sound Shore was rated against the following numbers of U.S.-domiciled Large Value funds over the following time periods: 1045 funds in the last three years, 930 funds in the last five years, and 598 funds in the last ten years. With respect to these Large Value funds, Sound Shore received a Morningstar Rating of 2, 3, 3 stars for the three-, five- and ten-year periods, respectively. The fund experienced negative performance during some of these periods. **Past performance is no guarantee of future results.** Data is as of 12/31/12.

Morningstar Analyst Rating

The Morningstar Analyst Rating is not a credit or risk rating. It is a subjective evaluation performed by the mutual fund analysts of Morningstar, Inc. Morningstar evaluates funds based on five key pillars, which are process, performance, people, parent, and price. Morningstar's analysts use this five pillar evaluation to identify funds they believe are more likely to outperform over the long term on a risk-adjusted basis. Analysts consider quantitative and qualitative factors in their research, and the weighting of each pillar may vary. The Analyst Rating ultimately reflects the analyst's overall assessment and is overseen by Morningstar's Analyst Rating Committee. The approach serves not as a formula but as a framework to ensure consistency across Morningstar's global coverage universe.

The Analyst Rating scale ranges from Gold to Negative, with Gold being the highest rating and Negative being the lowest rating. A fund with a "Gold" rating distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. A fund with a 'Silver' rating has notable advantages across several, but perhaps not all, of the five pillars-strengths that give the analysts a high level of conviction. A "Bronze"-rated fund has advantages that outweigh the disadvantages across the five pillars, with sufficient level of analyst conviction to warrant a positive rating. A fund with a 'Neutral' rating isn't seriously flawed across the five pillars, nor does it distinguish itself very positively. A "Negative" rated fund is flawed in at least one if not more pillars and is considered an inferior offering to its peers. Analyst Ratings are reevaluated at least every 14 months.

For more detailed information about Morningstar's Analyst Rating, including its methodology, please go to http://corporate.morningstar.com/us/documents/MethodologyDocuments/AnalystRatingforFundsMethodology.pdf.

The Morningstar Analyst Rating should not be used as the sole basis in evaluating a mutual fund. Morningstar Analyst Ratings are based on Morningstar's current expectations about future events; therefore, in no way does Morningstar represent ratings as a guarantee nor should they be viewed by an investor as such. Morningstar Analyst Ratings involve unknown risks and uncertainties which may cause Morningstar's expectations not to occur or to differ significantly from what we expected.