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ValueInvestor INSIGHT

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Evolution of a Manager

In Joel Greenblatt's first incarnation as an investor, he earned outsized returns with a concentrated value strategy often focusing on special situations. The value emphasis remains, but his portfolio approach today is far different.

Having put up a remarkable long-term record as a hedge fund manager, Joel Greenblatt has hardly moved on from the world of value investing. He continues to teach a highly sought after "Value and Special Situation Investing" class at Columbia Business School. He's written three books since his 1997 classic, *You Can Be A Stock Market Genius*, including *The Little Book That Beats the Market*, a runaway bestseller. Gotham Asset Management, co-managed with partner Robert Goldstein, remains in the investment game, having recently added three long/short mutual funds, Gotham Enhanced Return [GENIX], Gotham Absolute Return [GARIX] and Gotham Neutral [GONIX], to its lineup of private funds.

As a concentrated hedge fund manager, Greenblatt specialized in rooting out inefficiently priced "special situations" – involving such things as spinoffs, corporate restructurings and mergers – and taking heavily weighted positions in stocks offering the greatest discounts to his assessment of intrinsic value. Six to eight names made up 80%-plus of his portfolio and high volatility came with the territory. "Every two or three years we could lose 20-30% of our net worth over a very short period of time," he says. "That's what happens when you run a concentrated book."

While Greenblatt says the relative and absolute valuation methodologies he relies on haven't changed since his earlier hedge fund days, the approach to portfolio management taken in managing Gotham's new mutual funds is markedly different. Relying heavily on customized valuation analysis conducted by Gotham's 13-strong research team, the largest market-cap

Pros and Cons

Below are ten prominent long positions and ten prominent short positions in the mutual fund portfolios managed by Gotham Asset Management's Joel Greenblatt. The longs tend to favor well-known blue chips, while the shorts lean toward market darlings and putative turnarounds.

	Ticker	Price@ 3/28/14	P/E (TTM)	52-Week		Price Vs. 52-Week High
				Low	High	
LONGS						
Amdocs	DOX	45.78	17.9	34.07	46.85	(-2.3%)
Anixter	AXE	98.49	16.3	64.94	115.84	(-15.0%)
Columbia Sportswear	COLM	81.77	30.1	55.58	88.25	(-7.3%)
Danaher	DHR	73.87	19.5	57.61	78.80	(-6.3%)
Mondelez	MDLZ	34.40	15.7	28.22	36.05	(-4.6%)
National Oilwell Varco	NOV	77.67	14.3	63.08	84.71	(-8.3%)
News Corp	NWSA	17.03	n/a	14.39	18.53	(-8.1%)
PepsiCo	PEP	82.95	19.2	77.01	87.06	(-4.7%)
Qualcomm	QCOM	79.28	20.3	59.02	79.72	(-0.6%)
Verizon	VZ	47.42	11.8	45.08	54.31	(-12.7%)
SHORTS						
Abercrombie & Fitch	ANF	38.78	56.2	31.14	55.23	(-29.8%)
Acacia Research	ACTG	14.82	n/a	12.23	30.74	(-51.8%)
Amazon.com	AMZN	338.29	573.4	245.75	408.06	(-17.1%)
Carnival	CCL	37.24	26.8	31.44	41.89	(-11.1%)
Kate Spade	KATE	37.00	62.7	18.13	40.75	(-9.2%)
K12	LRN	22.10	184.2	17.15	38.14	(-42.1%)
Life Time Fitness	LTM	48.07	16.4	40.15	56.94	(-15.6%)
Sprouts Farmers Market	SFM	36.47	98.6	33.00	49.45	(-26.2%)
Stratasys	SSYS	104.43	n/a	67.92	138.10	(-24.4%)
Valeant Pharmaceuticals	VRX	127.68	n/a	69.87	153.10	(-16.6%)

Sources: Gotham Asset Management, other publicly available information

companies in the U.S. are ranked from 1 to roughly 2,000 based on the discount from the team's assessment of value – number 1 trading at the largest discount and number 2,000 trading at the largest premium. The portfolios are then regularly updated to stay long in the cheapest 300 or so stocks and short in the most-expensive 300. Position weights aren't equal, so the further a stock is from estimated intrinsic value, the more of it the portfolio is long or short.

As for the three different strategies, each is meant to satisfy a separate need in an institution's or individual's portfolio. The Enhanced Return Fund, for example, maintains a net long exposure of 100% – roughly 170% long and 70% short – and is meant to be a "smarter way" to be 100% long, says Greenblatt. He explains it as looking to benefit from two sources of returns. For each $100 invested in the strategy, the first source is the return on $100 invested in a portfolio of what Gotham considers the cheapest stocks. The second potential source is the "spread" between how much an additional investment of $70 in its long stock selections returns versus the returns on $70 in chosen shorts. If the longs outperform the shorts over time, that will add to returns.

The mechanics are similar for the other two funds, though the Absolute Return Fund maintains a net long exposure of 50-60% and the Neutral Fund looks to earn returns primarily from the long/short spread. Might the more bullish favor the 100%-long fund and the more bearish the neutral one? "I wouldn't use these for market timing," says Greenblatt, "because I assume not many people would be good at that."

ON HIS NEW APPROACH:

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Does the more regimented and diversified style of his new funds mean he's concluded his original strategy is less viable? Not at all, he says: "Were I starting out again, I'd do it exactly the same as before. With the concentrated hedge fund strategy we made very high returns over a long period of time and I was okay with the volatility because I knew the underlying securities very well and as long as they remained cheap, I had no problem sticking with them. The approach now is probably the better strategy for most people. We're still fundamental value investors and I expect very good long-term returns, but the ups and downs should be much less severe. That means people are more likely to stick with it, which should turn out far better for them in the long run."

For the table on the previous page, Greenblatt and partner Goldstein have identified ten prominent longs and ten prominent shorts from their current portfolio. It's an eclectic mix, with the longs leaning toward well-known blue chips such as PepsiCo and Qualcomm. Two longs, Mondelez and News Corp, have in the past year become newly independent companies as a result of their former parents splitting in two.

Among the portfolio's shorts are longtime market darlings Amazon.com and Valeant Pharmaceuticals. Also don't count Gotham among the value investors who see potential turnarounds at teen retailer Abercrombie & Fitch and cruise operator Carnival, both among their favorite shorts. VII

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