

# SmartMoney

## patience for profits

By Reshma Kapadia

John Rogers Jr. runs his mutual funds the same way he plays basketball—he waits for the right opportunity. After two so-so years, is it time for his stocks to shine?

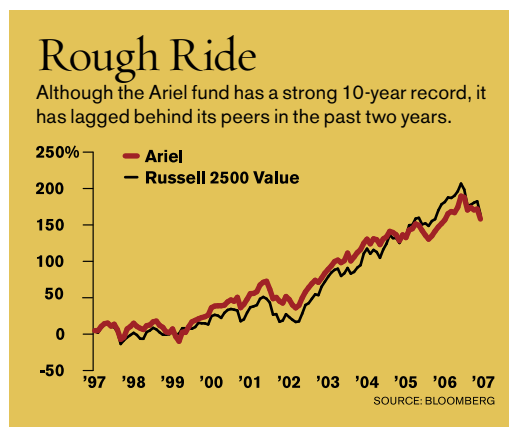
**W**ATCH JOHN ROGERS Jr. on the basketball court and it's not hard to figure out the mutual fund manager's style. When the ball is up for grabs, the 49-year-old dives for it—even on pavement. When playing defense he digs in his heels and stands firm as opponents charge into him. And when he gets the ball, Rogers will wait and wait, forgoing a 16-foot jumper for a surefire layup. Longtime friend Arne Duncan says Rogers wasn't the biggest guy on the court in high school or at Princeton University, but he still stood out. "He wanted to win, and he played harder than anyone else," he says.

Rogers, the founder and CEO of Chicago-based Ariel Capital Management, applies the same disciplined approach to the investing world. Before heading to work every weekday, he puts on a gray pinstripe suit and grabs a McDonald's

sausage biscuit for breakfast. In searching for the best investments, he goes so far as to run background checks on top management, just to make sure they're on the up-and-

up. And when he finds a stock he likes, he'll stick with it for years. He's held stakes in Clorox and T. Rowe Price for more than 20 years, an eternity in an industry full of fund managers chasing the latest hot stocks. That kind of patience has paid off. Over the past decade, his flagship Ariel fund returned an average of 10 percent a year, four percentage points better than the Standard & Poor's 500-stock index.

But that same tenacity can look like stubbornness when the market moves against him. As investors chase the latest strategies to cope with a volatile market, Rogers is a reminder of both the virtues and the cost of sticking with the same approach year in and year out. Although his contrarian bets have paid off over the long



term, the \$3.9 billion Ariel fund has lagged behind its peers for the past two years, as Rogers and his team sat out the rally in energy stocks and the market ignored the high-quality companies Rogers prefers. As a result, the Ariel fund lost more than \$1 billion in assets, because some clients took their money elsewhere. “There are going to be times when our style is out of favor, and John takes it very personally,” says Charlie Bobrinsky, Ariel’s director of research. Rogers responds by hunkering down, reexamining the calculations and assumptions behind his investment decisions.

After just two years as a stockbroker, Rogers started Ariel at the age of 24, adopting Aesop’s fabled tortoise as its symbol. Seeking business for what would become the first minority-owned mutual fund company, he began knocking on the doors of pension funds, college endowments and municipalities to convince them that a young black man with a long-term view could manage their millions. It took three years for the firm to break even, but Ariel now manages more than \$14 billion in assets. Ariel’s funds, which count Ariel Appreciation and Ariel Focus among them, typically hold only about 35 stocks, which means Rogers takes big gambles in what he considers unloved but still high-quality names with solid balance sheets, steady cash flow and strong management. Even in his extracurricular activities—which include serving on corporate and nonprofit boards and sounding the alarm on the huge gap in retirement savings between blacks and whites—Rogers is often sussing out investment ideas. As a John S. and James L. Knight Foundation trustee, he chats up newspaper publishers, who have helped convince him that a turnaround is near and that his gutsy wagers in their industry will pay off.

We spoke to Rogers on a recent sunny Sunday in his 29th-floor downtown Chicago office, with the blue water of Lake Michigan far below. In a conference room named after Pete Carril—his basketball coach at Princeton—Rogers told us why doom and gloom spells opportunity, why he sold mortgage giant Countrywide Financial after an uncharacteristically short time and why he looks for companies that understand the value of diversity.

**SMARTMONEY:** *Your dad first got you involved in investing, giving you stocks instead of toys at Christmas. That doesn’t sound like much fun.*

**JOHN ROGERS:** My dad had a lot of rules he had set up for me before I was born. He had a set time when I should have a checking account and a savings account. He wanted me in the stock market at 12 and a summer job at 16. It was all set in stone. At first it really wasn’t fun getting stocks. It took a while until the dividend checks became meaningful. Then that really started to get your attention.

**SM:** *What areas of the market are getting your attention right now?*

**JR:** There’s always opportunity when there’s lots of gloom and doom in an industry. We’ve gotten lots of criticism over it, but we’re sticking



with newspapers and magazines, because we believe in small and midsize companies like McClatchy, Lee Enterprises, Gannett. We think the bad news is overblown and 2008 is going to be a turnaround year.

**SM:** *Why?*

**JR:** The consortiums being built with search-engine companies like Yahoo are doing better than anticipated, and revenue generation from those partnerships is going to be larger than people expect. Yahoo has talked about the importance of the local content these newspapers provide. The people on the ground who sell advertising in local communities know where the ad dollars are; national companies can’t really replicate that success. And the newspaper companies that have a lot of advertising that is housing related have seen those dollars disappear. That’s not

going to be forever. Eventually, the housing markets will turn.

**SM:** Real estate also has a big cloud hanging over it. Anything look good?

**JR:** We have looked at home builders but haven't pulled the trigger. But where we have invested are companies tied to real estate, like USG, which makes wallboard; carpet manufacturers Mohawk and Interface; and companies like Black & Decker. Those stocks have all been relatively very cheap, and we continue to add to them.

**SM:** You owned Countrywide at one point in 2007.

**JR:** Briefly. We bought it and decided it was too risky. It was not one of our best moments.

**SM:** Why did you change your mind?

**JR:** We like to buy when headlines are horrible. It's what we've always done. We thought all the bad news was reflected in the price, so it's been amazing to me to see earnings estimates come down again and again.

**SM:** Financials have also been under attack. What's interesting there?

**JR:** The area that we've had the most success in is mutual fund companies.

**SM:** Your biggest position is in Janus, which you bought at the bottom of the bear market in 2002. It's tripled since then. Is the valuation getting too rich?

**JR:** Large-cap-growth stocks are popular again. Janus has top-of-the-chart performance within that sector, so fund flows are going to just explode if the market is flat or up, because there aren't that many

brands left of pure large-cap-growth managers. During this tough period Janus has developed different ways to sell their products. Valuations are still very, very low, and I wouldn't be shocked to see a strategic buyer come in.

**SM:** What else is attractive?

**JR:** Insurance companies are very cheap. A lot of them are selling at single-digit price/earnings ratios and run the gamut from Markel and Horace Mann to financial guarantors like Assured Guaranty Ltd. In the property and casualty market, pricing power just isn't there right now, but these cycles come and go. The companies that are good at underwriting risk are conservative and know what they are doing will shine.

**SM:** You also like some banks.

**JR:** We have companies that are not only good at lending money but are also good at providing financial products and have recurring revenue streams. Our biggest position is Northern Trust, which has a great wealth-management business and does a lot of back-office, custodial work for large institutions. A similar story, but not as successful yet, is City National. Both have wonderful brands in their respective regions, great management and a good model that is not tied to the economic cycle.

**SM:** You predicted a 10 percent market correction last January.

What now?

**JR:** For us to dip into some mild recession would not be a shock to me. I wouldn't be surprised to see us go through a malaise kind of market. People have gotten too trained that you buy the weakness and the market will always come back. It just isn't that easy.

**SM:** What does that mean for your style of value investing?

**JR:** For the past 25 years, we have outperformed in difficult markets. I think we are well positioned to do so, because the indices are chockablock with energy, cyclical names and lower-quality stocks. When the market shifts to higher-quality, less-cyclical names, we will do well.

**SM:** After the four-year run in small and midsize companies, these stocks are no longer the secret they were when you started. How does that change your job?

**JR:** The universe for the gems we've spent our career looking for is much smaller. With the massive consolidation in so many industries in the past five years, you can go from one great industry niche to another where the player that's left is midsize because it has gobbled up all the smaller companies. In this global economy it is harder and harder to be a small player. The ones that are left are much higher risk. I like small and midsize

companies. It's just a matter of moving between the two areas for where opportunity is, and I see them more clearly right now in midsize.


**SM:** You often do background checks on management when searching for companies. What are you looking for?

**JR:** Whether people are who they appear to be. Have they graduated from the schools that they say they have? Are there arrests for domestic violence or drunken driving? Do they pay their bills on time? Are they upstanding people?

**SM:** You have talked about the lack of diversity in corporate America. Do you look at a company's diversity policy when investing?

**JR:** It is part of the mosaic in determining if the management team is smart or not, do they get it or not. We ask questions and have been able to move the needle somewhat and push companies to have their Jackie Robinson moments. If they are really stubborn, have no excuses and no good reasons about the lack of diversity, it affects our view on how smart, thoughtful and talented management is.

**SM:** What was it like in 2006 and 2007, when the fund lost some assets as Ariel sat out the energy-and-materials-fueled rally and higher-quality stocks suffered?

**JR:** There are very few absolutes in this industry—very few. But one is, whatever worked in the market for a long time in the past is not going to work for you in the future. These things come and go. We know if we stick to discipline and execute well, it will come back to our kind of market. But that doesn't mean that as a competitor, you're not working to see how you can be better. 

## Rogers' picks

The Chicago fund manager looks for companies that have solid balance sheets, steady cash flow and strong management.

COMPANY (TICKER)	PRICE (\$)
Horace Mann Educators (HMN)	19
Janus Capital Group (JNS)	34
McClatchy (MNI)	13
Northern Trust (NTRS)	77
USG (USG)	36

\*Prices as of 12/11/07.

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To see a video interview with John Rogers, go to [www.smartmoney.com/tv](http://www.smartmoney.com/tv).



## Investing in the Future

At Ariel Community Academy, students learn all the basics—like understanding financial statements and why good credit is important. You know, kid stuff.

**I**T'S A TYPICAL DAY FOR THE ANALYSTS: RIGHT now they're debating whether or not Starbucks stock is a buy. Two bulls and three bears are disputing the firm's competitive edge. Only here the analysts are a bit on the young side—in fact, they're all under 15.

Denzell Hargrove, a quick-witted 14-year-old outfitted in his school's blue uniform, argues that Starbucks has too many stores, and competition from McDonald's is intensifying. "But we drove to a bunch and found that most Starbucks were packed," counters his classmate Miriam Hill-Odom, a 13-year-old whom teachers call "strong-willed." No decision is reached, though the group later agrees to sell Aeropostale. Another debate ensues as to whether they should dump that stock before or after Christmas.

If you're one of the cynics who thinks stock picking is something any eighth-grader can do, you may be right. In an imposing brick building on the south side of Chicago stands the Ariel Community Academy. While its name might sound like an elite prep school's, ACA is a public school that strives to ensure its students—most of whom are African American and come from low-income, single-parent households—learn something about investing. From pre-kindergarten through eighth grade, financial literacy is woven through their classes in a way few other schools have tried. Second-graders learn economic fundamentals: "Scarcity is like when you have a sleepover and there are five kids but you only have four toys," explains Noah Lewis-Stuart, 7. Middle-schoolers analyze income statements and annual reports. Then, at the tender age of 12, students get their first shot at becoming fund managers, running a portfolio of more than \$20,000.

The school is the brainchild of John Rogers Jr. and his firm's foundation. In the mid-1990s, Chicago's mayor took over all the city's schools and allowed businesses to adopt them. In 1996 ACA opened its doors. Since then Ariel's foundation has donated several million dollars, with an ambitious goal: to give students a solid education and the skills needed to be financially sound. "Graduating and getting a job isn't enough," says Arne Duncan, chief executive of the Chicago Public Schools and ACA cofounder. "They have to be able to manage their money."

Financial literacy is a problem for most American students—and an even bigger one for African Americans. More than half of American high school seniors missed the most basic investing questions, according to Jumpstart Coalition for Personal Finance Education. African-American seniors scored

even worse—which may account for the fact that adult African Americans aren't in the best financial shape either. Even after adjusting for education and income levels, African Americans' nest eggs are less than half their white peers', according to a recent survey by Charles Schwab and Ariel Mutual Funds. The firms' annual survey also found that only 57 percent of blacks invest in stocks—creating a large gap in retirement savings that Rogers has said could be the next generation's big civil rights issue.

At ACA students take all the basics—from biology to Spanish—but also classes on entrepreneurship and international investing. Financial and economic concepts are reinforced in every class; globalization ties into social studies, for example. But perhaps the most unusual aspect of the program is the \$20,000 each incoming first-grade class gets from Ariel and Chicago-based Nuveen Investments, another contributor. The two firms manage the portfolio until the students reach seventh grade—at which point the kids start calling the shots. When they graduate, they return the initial \$20,000. Half the gains go toward a school gift; the rest is split evenly among the students. How they spend it is their business, but school officials say instead of splurging on a Nintendo Wii, many kids contribute the money to a 529 college savings plan.

And it's money well earned. The class gets twice-daily market updates, but that's not enough for 13-year-old Niji Lomax. He gets text messages whenever Google's stock moves 10 percent: "If I see it move a lot, I'll be thinking about it all day." The eighth-grade portfolio stands at \$30,771—a 12 percent return since the kids took it over, trailing the S&P by three points. Why? Aeropostale fell 33 percent while they were on summer break.

But money management isn't the whole story. According to school officials, 95 percent of Ariel's eighth-graders meet or exceed state standards for math, surpassing the scores of the district's black students by 34 percentage points and the city's white students by seven percentage points. What's more, students say they're bringing their financial acumen home. Destiny Davis, 14, came home talking about municipal bonds; the next day her father, Steve, says he called Connie Moran, the school's investment-program director, and asked for more information—he had never heard of these bonds. He now owns a mini fund.

Myles Gage, a thoughtful 14-year-old, has his own goals: "We won't be working until we're 70," he says. "We'll already be retired, probably by the time we get to middle age."

—R.K.