



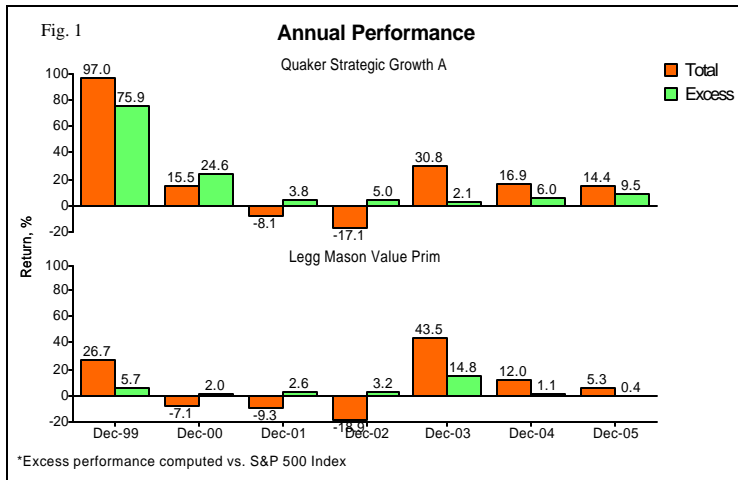
Bill Miller vs. Manu Daftary:  
2005 Duel Results  
A Returns-Based Style Analysis Perspective

*By: Michael Markov, CEO of Markov Processes International, LLC*

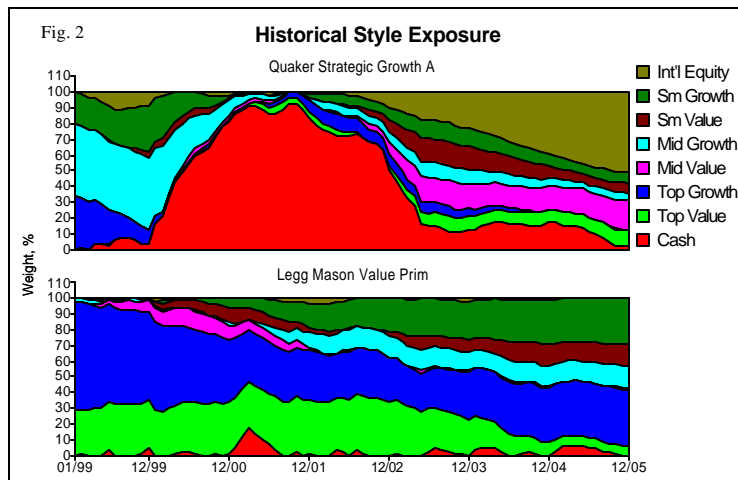
## Bill Miller vs. Manu Daftary: 2005 Duel Results

### A Returns-Based Style Analysis Perspective

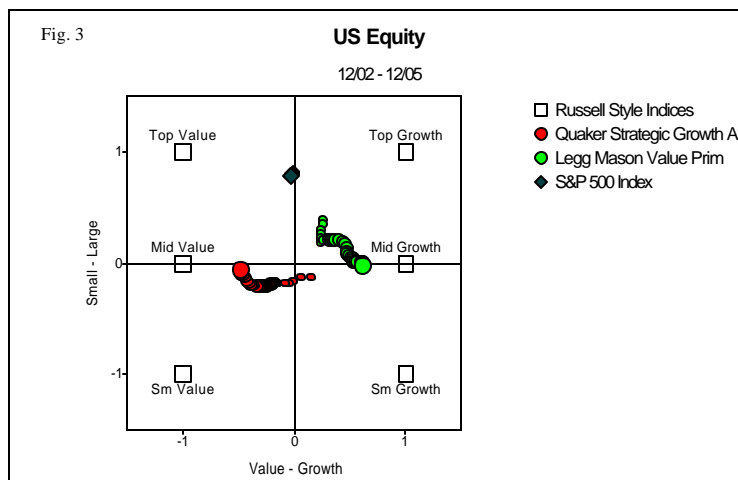
With the end of 2005 approaching, two funds in particular had been the focus of both the media and investors: Bill Miller's Legg Mason Value Trust and Quaker Strategic Growth Fund managed by Manu Daftary. Both funds had enjoyed the longest winning streaks over the S&P 500 index - seven years for Mr. Daftary and 14 for Mr. Miller. Now that we've crossed the finish line, it is clear that both managers added another winning year to their track record. It is worth noting, however, that the 2005 results were quite different for the two funds. With S&P 500 return being 4.9% for the year, the Quaker fund outperformed the index by 9.5%, while the Legg Mason fund beat the index by a mere 40 basis points (0.4). Both results are reflected in Figure 1 showing fund annual performance and excess return over the S&P 500 Index.



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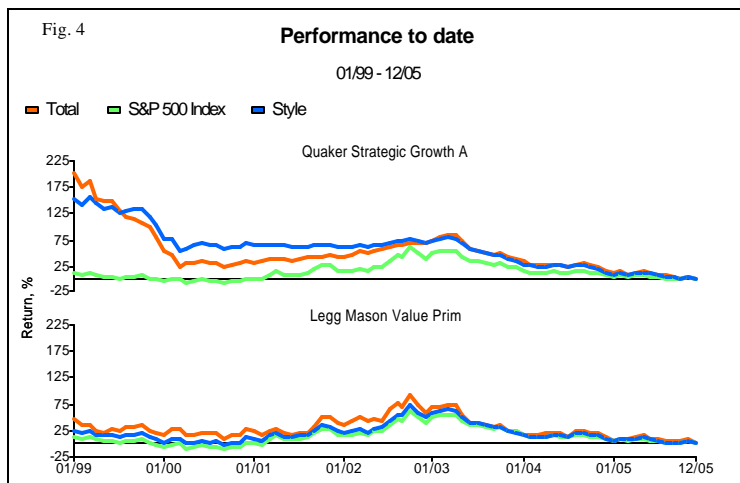
Although both funds have consistently outperformed the market, they employ very different strategies. The \$14B+ Legg Mason Value Trust is a highly concentrated portfolio with about 40% in top ten stocks. Quaker Strategic Growth Fund has about \$800M in assets and is more diversified. At the same time, Mr. Daftary's management style appears to have few restrictions - he can take the fund pretty much anywhere - sell 80% of the portfolio or sell stocks short.

We will use Returns-Based Style Analysis ("RBSA") to gain insight into the funds' performance results over the past year. The results of the analysis are shown in Figure 2. Each vertical line on this graph represents a "best fit" portfolio of market indices that explains the return behavior of the manager at any point in time. By following these returns-based "style portfolios" over time, one can assess style drift and the overall behavior of the fund.

The Quaker fund's asset class exposure swings appear to be very dynamic, as compared to the Legg Mason fund. Note the timing and the magnitude of the cash position (red area) maintained in 2000-2001 by Mr. Daftary, which is a publicly known fact. Another notable trend of the fund is its significant recent exposure (over 50% in our returns-based analysis) to international equities. We analyzed the fund's SEC filings as of Sep 30, 2005 and noticed a large number of foreign companies, ADRs as well as US companies in Oil and Energy sector with significant presence abroad. All this makes the portfolio highly sensitive to foreign market moves, which is reflected in Figure 2. Bill Miller's fund trend appears more systematic with the major trend being its move into smaller capitalization growth companies. It is important to note that returns-based analysis does not determine the actual investments held by the fund, but rather the factors that best explain its performance.

As is clearly seen on the Style Map in Figure 3, the funds have quite different returns-based styles and positions, and also appear to be very different from the S&P 500 Index. The "Snail trails" on this graph are derived from the area chart in Figure 2 and represent relative positions in both style and capitalization to Indices (represented by squares). The smaller circles represent earlier periods and larger circles the most recent periods. Both funds have drifted

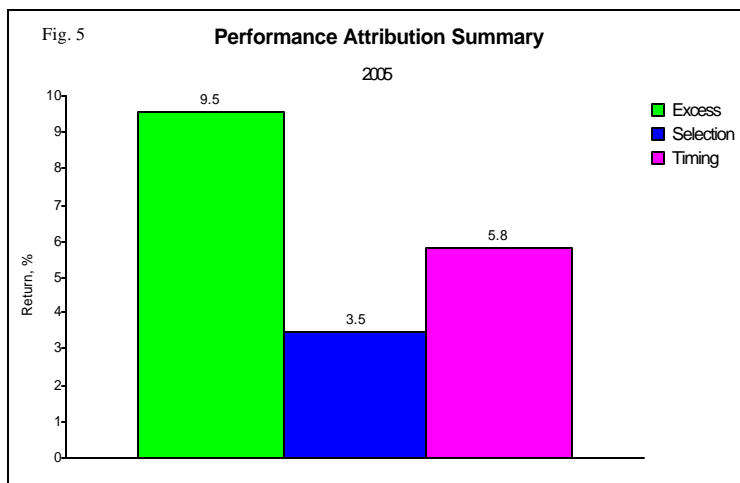
over the past several years both in Style and capitalization with the Quaker fund moving into the Value area of the chart (Oil, Energy, Financials) and the Legg Mason fund turning to growth stocks with smaller capitalization. We would like to note that this entire analysis was performed using only monthly returns for the funds and market indices.



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The chart in Figure 4 compares the performance of each fund to that of the S&P 500 Index, as well as its own underlying Style benchmark for every point over the past seven years through December 2005. The Style benchmark is derived from our returns-based analysis using the indice proportions depicted in Figure 2. These Style benchmarks represent systematic exposures of the funds to styles and/or sectors - specific securities bets are not reflected.

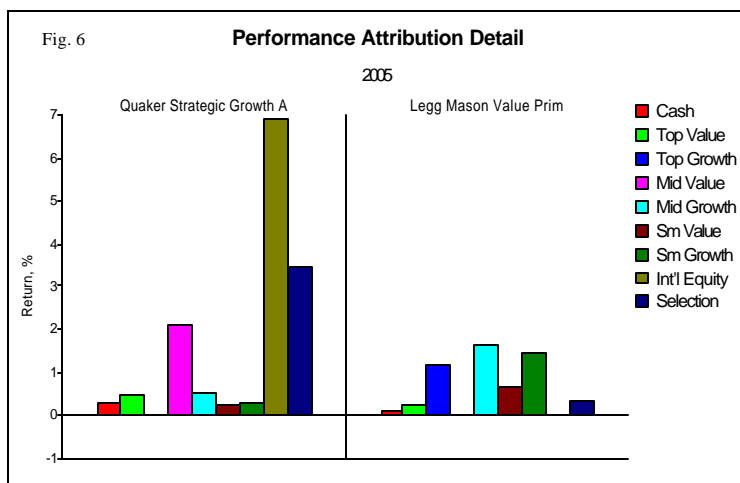
Note that both funds' performance lines lay above the S&P500 line, which means that both funds outperformed the index from any date in the past through Dec 2005. At the same time, while the Legg Mason fund always outperformed its Style benchmark, there is a period in 2000-2002 where the Quaker fund is below its Style benchmark. This indicates that the security selection bets made by Mr. Miller appear to have been consistently good (high), while the major driver of Mr. Daftary's performance appears to have been market and sector timing with security selection at times being possibly detrimental to the fund's performance.



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The above information is summarized in the "Performance Attribution Summary" in Figure 5 which presents the complete story of the Quaker fund's performance in 2005. Using only returns-based analysis, it shows the fund's total amount of excess return over the S&P 500 index performance, as well as the portion attributable to style/size bets (Timing) and security selection (Selection). The major portion of the Quaker fund excess performance, 5.8%, apparently comes from its bets on styles and sectors, which is consistent with industry analyst and media assessment of the management style.

In Figure 6 we present returns-based attribution analysis of both funds' performance for the year. It shows return components attributed to various indices which allow us to understand the major contributors to the total return. As expected, the Quaker fund's exposure to foreign markets was primarily responsible for the fund's performance results in 2005.



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## Summary

Returns-Based Style Analysis is an invaluable tool in understanding the sources of a fund's performance results. Using publicly available performance data, it allows one to gain insight into the fund manager's style and skill. In addition, it may provide insights into major factors that may significantly influence the fund's performance in the nearest future, i.e., risk management.