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Announcing Managers of the Year for 2008

Fund Spy | 01-06-09 | By Russel Kinnel

No matter how you slice it, fund investors and managers alike suffered a setback in 2008. Outside of a handful of bond funds, just about everyone lost money—and not just a little but staggering amounts. The average fund lost more than 30% in 2008.

So, why give out awards when everyone's year-end statement is swimming in red ink? Because limiting losses was difficult to do, yet incredibly valuable. Consider that our winning Domestic-Stock Manager of the Year lost just under 20% when the stock market as a whole lost 37%.

Limiting losses makes it much easier for an investor to get back in the black. To make up for a 20% loss, an investor would need to gain 25%. And to make up for a 40% loss, an investor would need to gain 67%. That's tough to do. Vanguard 500 Index (VFINX) has produced three-year gains of 25% or greater in two thirds of the rolling three-year periods since 1978, but it has produced gains of 66% or more in only about a third of those rolling periods.

Moreover, our Manager of the Year award recognizes much more than a single year's performance. It recognizes long-term performance and strong stewardship as well. In fact, it's more a hall of fame than a recommendation list. If you're looking for funds that we think have a bright future, see our Fund Analyst Picks list.

Domestic-Stock Manager of the Year: Charlie Dreifus of Royce Special Equity (RYSEX)
A couple of years ago, we recommended Royce Special Equity as an Analyst Pick, and a few readers wrote to ask if we were serious/crazy/stupid. Maybe crazy and stupid, too, but we were definitely serious. Charlie Dreifus is the sort of investor we're confident in when the market turns south. He'll buy only stocks that trade at a steep discount to his intrinsic-value estimates. That means he'll miss out on some fast-growing companies, but his approach protects against losses in tough times. He also demands high returns on invested capital and is a stickler for clean accounting and strong balance sheets. In fact, accounting guru Abe Briloff of Baruch College was a mentor.

Thus, when accounting scandals hit and people lose faith in companies' risk controls, Royce Special Equity is a good place to be. The fund held up brilliantly in the bear market of 2000-02 and has done so once more. True, its strategy isn't one that lends itself to powerful rallies—hence the quizzical reader e-mails in 2006—but it has produced solid long-term returns with less risk than most. Moreover, Dreifus put shareholders' interests first when he closed the fund at a small asset base (unlike some Royce funds that got a bit bloated). He later reopened when redemptions shrunk the asset base. Dreifus' record extends well beyond that of Royce Special. He also produced strong returns at Lazard and Oppenheimer.

In 2008, the fund lost 19.5%. That's an impressive 1,400 basis points better than the category average. The fund's small-value stomping grounds were full of dangerous value traps, such as mortgage lenders, real estate plays, and a slew of cyclical stocks that were highly dependent on financing. Dreifus avoided all that quite nicely, and he even had a handful of winners like National Presto (NPK), Watsco (WSO), and Wabtec (WAB).

Russel Kinnel is Morningstar's director of mutual fund research.

This is only an excerpt of the full article. The sections on Fixed-Income Manager of the Year and International-Stock Manager of the Year have been omitted for reprint purposes. To read the full article, please visit www.morningstar.com.

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Royce Special Equity Fund

MORNINGSTAR 2008 **Fund Manager of the Year** Domestic Equity

Royce Special Equity Fund (RSE) uses a disciplined value approach that traces its roots to the teachings of Benjamin Graham and Abraham Briloff. This approach combines classic value analysis with accounting cynicism. The Fund focuses on companies with market capitalizations up to $2.5 billion, attempting to find inexpensive companies with high returns on invested capital and low leverage. We believe that investors in the Fund should have a long-term investment horizon of at least three years. Charlie Dreifus manages the Fund.

Morningstar awards "Fund Managers of the Year" based on their respective Fund's current year performance, long-term performance, fund assets and investment strategy consistency. Morningstar also looks for managers who "are great stewards of shareholders' interests and who stay with their proven strategies rather than follow investing trends."

Charles R. Dreifus, Portfolio Manager Principal of Royce & Associates; 40 years of investment industry experience, 10 years with Royce; BBA, City College of New York, MBA, Baruch College

Important Performance and Expense and Disclosure Information

PERFORMANCE: ROYCE SPECIAL EQUITY FUND VERSUS RUSSELL 2000 As of December 31, 2008

	Average Annual Total Return			
	One-Year	Five-Year	10-Year	Annual Operating Expenses
Royce Special Equity	-19.62%	1.60%	8.15%	1.11%
Russell 2000	-33.79	-0.93	3.02	n.a.

All performance information reflects past performance, is presented on a total return basis and reflects the reinvestment of distributions. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, so that shares may be worth more or less than their original cost when redeemed. Shares redeemed within 180 days of purchase may be subject to a 1% redemption fee payable to the Fund. Current performance may be higher or lower than performance quoted. Current month-end performance may be obtained at www.roycefunds.com. Operating expenses reflect the Fund's total annual operating expenses for the Investment Class as of the date of the Fund's most current prospectus, and include management fees and other expenses. All performance and risk information for RSE reflects Investment Class results. Shares of RSE's Service and Consultant Classes bear an annual distribution expense that is not borne by the Investment Class.

The Fund invests primarily in small- and micro-cap stocks which may involve considerably more risk than investing in larger-cap stocks (Please see "Primary Risks for Fund Investors" in the prospectus). The Fund also invests primarily in a limited number of stocks, which may involve considerably more risk than a less concentrated portfolio because a decline in the value of any one of these stocks would cause the Fund's overall value to decline to a greater degree.

This material is not authorized for distribution unless preceded or accompanied by a current prospectus. Please read the prospectus carefully before investing or sending money. The Russell 2000 is an unmanaged, capitalization-weighted index of domestic small-cap stocks. It measures the performance of the 2,000 smallest publicly traded U.S. companies in the Russell 3000 index. Distributor: Royce Fund Services, Inc.

Russell Kinnel's thoughts in this piece concerning Mr. Dreifus's investment approach, the historical performance of Royce Special Equity Fund and the stock market are solely his own and, of course, there can be no assurance with regard to future market movements. No assurance can be given that the past performance trends as outlined above will continue in the future. The historical performance data and trends outlined are presented for illustrative purposes only and are not necessarily indicative of future market movements. In addition, there can be no assurance that the securities mentioned in this piece will be included in the Fund's portfolio in the future. As of 12/31/08, National Presto (NPK) represented 7.3%, Watsco (WSO) 1.8%, and Wabtec (WBO) 1.3%, of the Fund's net assets.