

A Fund Firm Where Downside Is as Important as Upside

Osterweis knows steep losses can kill a fund and tries to avoid them.

Fund Spy | 08-11-10 | by Dan Culloton

Osterweis—a firm founded and run by a seasoned investor and backed by another pretty good investor.

John Osterweis was a professional analyst and money manager for more than a decade before opening his eponymous firm in 1983 with the financial backing of running buddy and private-equity investor Warren Hellman, founder of Hellman & Friedman. The firm focused on private accounts for about a decade before launching its first mutual fund, The Osterweis Fund (OSTFX), in 1993. The firm has launched just one fund since, The Osterweis Strategic Income Fund (OSTIX), a fixed-income fund, in 2002, though it recently filed papers with the Securities and Exchange Commission to launch a fund that combines its stock and bond strategies in one package.

Brother-in-Law Funds

Investing, not asset gathering, seems to drive this firm. It originally started its first mutual fund for relatives of its wealthy clients who couldn't meet the minimum investments for separate accounts (sometimes referred to as a *brother-in-law fund* in money-management parlance). It waited about a decade before hiring someone to market the fund to fee-only financial advisors. The firm also has shunned the No Transaction Fee marketplaces of brokers, such as Charles Schwab (though the fund is available at many of them for a fee), and claims to have turned down acquisition offers from larger firms partly out of fear of compromising strategy and performance by growing too fast.

The firm has grown steadily on its own since its early days, but it's still small by money-management standards, with about \$4 billion in assets across all its funds and accounts. Asset bloat is not a major concern here yet, though Osterweis has been willing to control assets by closing other accounts at times and by imposing 2% redemption fees on shares sold within 30 days on its funds.

Perhaps because of its long experience dealing with affluent investors, who tend to be more high maintenance than retail investors, the firm is

client-focused. This is exemplified in regulatory disclosures and shareholder communications that are concise and informative.

Eponymous

The source of Osterweis' culture, though, is Osterweis himself. He's a confident investor and businessman. When he was a young sell-side broker and analyst, Osterweis said he secured the confidence and ear of legendary investor Roy Neuberger by telling him that he was wrong about a stock and should sell it. Osterweis built his firm by doing a few things well—focusing on fundamental research and stock-picking, investing with conviction, avoiding unnecessary trading, and not losing money for clients. Both the equity and fixed-income funds lost less than market and their respective category peers in 2008. The funds will lag peers in some up markets, but Osterweis is OK with that as long as the end result is solid absolute long-term returns. So far, that is what it has done. The Osterweis Fund's nearly 11% 15-year annualized gain through Aug. 3, 2010, beats the returns of the market and typical category peer by wide margins. The Osterweis Strategic Income Fund's more than 7% five-year gain is very competitive as well.

The key to the firm's continued success will be Osterweis' ability to attract and retain people who share his approach. So far, Osterweis has been able to find people with sound credentials. The five other members of the stock fund's team, for example, include a former sell-side analyst from Morgan Stanley and former buy-side analysts and managers from American Funds advisor Capital Group and Franklin Templeton Investments. Osterweis and Hellman are still the biggest shareholders of the firm, but all of the managers also have ownership stakes in the firm, and their interests should grow as Osterweis and Hellman step back.

The Next Generation

The firm's biggest challenge will be maintaining its culture as it grows. Osterweis is fit and shows no sign of slowing down, but he's conscious of the need to prepare for the next generation. So far, he has been able

to attract a mix of experienced and new people who either share or can be inculcated with his investment approach and hasn't been afraid to make changes when employees don't seem to fit. He often holds up firms like San Francisco neighbor Dodge & Cox as his ideal of multigenerational cultural consistency. Time will tell if Osterweis the firm can achieve that kind of longevity and success. In many important ways, however, the firm has shown it is focused on the long-term interest of its fund owners. In recent years, for example, it has put breakpoints into its management fee schedules that will lower the expense ratios of its funds as assets grow. Such actions bode well for the future.



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THE OSTERWEIS FUNDS

Morningstar.com's Fund Spy

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The attached article references performance figures for the funds as of 8/3/2010. The Funds' average annual total returns for the one year, three year, five year, ten year, and since-inception periods ending 12/31/2011 were as follows:

	1 Year	3 Year	5 Year	10 Year	Since Inception (Fund Inception Date)
The Osterweis Fund	-4.29%	12.16%	0.89%	5.80%	10.28% (10/1/1993)
S&P 500	2.11%	14.11%	-0.25%	2.92%	7.69% (10/1/1993)
The Osterweis Strategic Income Fund	4.06%	12.70%	6.94%	n/a	7.97% (8/30/2002)
Barclays Capital U.S. Aggregate Bond Index	7.86%	6.78%	6.51%	n/a	5.46% (8/30/2002)

The Osterweis Fund's Expense Ratio as of 3/31/2011: 1.01%

The Osterweis Strategic Income Fund's Expense Ratio as of 3/31/2011: 0.98%

Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted above. Performance data current to the most recent month end may be obtained by calling (866) 236-0050. Shares redeemed within 30 days are subject to a 2% redemption fee. Performance periods shown above are greater than 30 days and do not reflect the redemption fee. If the investment period were shorter than 30 days, performance would be lowered by the amount of the redemption fee.

The S&P 500 Index is an unmanaged index which is widely regarded as the standard for measuring large-cap U.S. stock market performance. The Barclays Capital U.S. Aggregate Bond Index is an unmanaged index which is widely regarded as the standard for measuring U.S. investment grade bond market performance. The indices include reinvestment of dividends and/or interest income. The indices do not incur expenses and are not available for investment.

Mutual Fund investing involves risk. Principal loss is possible. The Osterweis Fund may invest in medium and smaller sized companies, which involve additional risks such as limited liquidity and greater volatility. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. The Fund may invest in Master Limited Partnerships, which involve risk related to energy prices and demand. The Fund may invest in debt securities that are un-rated or rated below investment grade. Such lower-rated securities may present an increased possibility of default, price volatility or illiquidity compared to higher-rated securities. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

(Over Please)

The Osterweis Strategic Income Fund is non-diversified, meaning it may concentrate its assets in fewer holdings than a diversified fund. Therefore, the Fund's share price may be more influenced by fluctuations in each holding's value than a diversified fund. The Fund may invest in debt securities that are un-rated or rated below investment grade. Such lower-rated securities may present an increased possibility of default, price volatility or illiquidity compared to higher-rated securities. The Fund may invest in foreign securities, which will involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Small- and mid-capitalization companies tend to have limited liquidity and greater price volatility than large-capitalization companies.

Opinions expressed in the article are those of the author and portfolio manager and the information has not been verified by Osterweis Capital Management. These opinions are subject to change at any time, are not guaranteed, and should not be considered investment advice. While the Fund is no-load, there are management and distribution fees that do apply.

References to other mutual funds should not be interpreted as an offer of these securities.

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The Osterweis Funds are available by prospectus only. The Funds' investment objectives, risks, charges and expenses must be considered carefully before investing. The summary and statutory prospectuses contain this and other important information about the Funds. You may obtain a summary or statutory prospectus by calling toll free at (866) 236-0050, or visiting www.osterweis.com. Please read the prospectus carefully before investing to ensure the Fund is appropriate for your goals and risk tolerance.

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