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When fund managers decide to launch their own shops, it can be tough to evaluate their new offerings—and not all are worthy. These four have successfully made the leap.

Introducing the New Guard

by Sarah Max

(The following has been excerpted.)

When C.T. Fitzpatrick launched his asset-management firm, Vulcan Value Partners, a few years ago, he had a pretty good idea of what to expect.

Not only had he watched his previous employer, Southeastern Asset Management, grow from a small firm to the $35 billion advisory behind noted value shop Longleaf Funds, he had spent more than two decades scrutinizing business models and management styles. "I took the best of what I'd seen and tried to put it into practice," says Fitzpatrick, whose Birmingham, Ala., firm now has 19 employees and more than $2 billion in assets under management.

The experience, he says, "gives me newfound respect for the companies I invest in."

Building a company from the ground up is no easy feat, no matter what the product or service. When that business happens to be mutual funds, the endeavor is particularly expensive, fraught with red tape, and slow-going in the early years. "That's the biggest culture shock for these managers," says Frank Strauss, a principal with Beacon Consulting Group, a Boston firm that advises asset managers. "As a manager at a bigger firm, your life is consumed with running the portfolio, but when you strike out on your own, you're managing the fund and the company. There's a lot to contend with out of the gate."

"It's like changing a tire at 60 miles an hour," says Robert Gardiner, a former Wasatch Advisors manager who co-founded Grandeur Peak Global Advisors in 2011. Like many bosses of start-ups, he teamed up with an expert in operations and marketing from the get-go. That allows him to focus solely on the investment side of the business, he says, though he's still cognizant of the extra responsibilities that come with being an owner.

The first few years can be the most difficult. Attracting assets—even for portfolio chiefs with name recognition—is always a hurdle because many investors and consultants won't look at new funds until they have a three-year track record and sizable assets. "Even the big players say it can take time to get a new fund onto distribution platforms," observes Cindy Zarker, a director of Cerulli Associates, also in Boston.

Meanwhile, there are a slew of fixed costs, for items ranging from office space and employees' pay to legal fees and advisory boards. That can send a fund's expense ratio through the roof, says Strauss, so much so that managers initially must waive fees or subsidize costs. "Depending on the type of fund and cost structure, you need $100 million to $200

New Funds, Seasoned Managers

These four funds are run by managers with long, proven track records who took the plunge to start their own companies. All the funds are less than three years old, and are still flying under the radar.

Fund/ticker	Manager	Former Firm	AUM (millions)	Expense Ratio	1-year return
Grandeur Peak Global Opportunies/GPGOX	Robert Gardiner/ Blake Walker	Wasatch Advisors	$380	1.75%	30.0%
RiverPark Large Growth/RPXFX	Mitch Rubin	Baron Capital Management	29	1.25	22.9
Seafarer Overseas Growth & Income/SFGIX	Andrew Foster	Matthews International Capital Mgmt	35	1.60	13.3
Vulcan Value Partners Small Cap/VVPSX	C.T. Fitzpatrick	Southeastern Asset Management	482	1.50	32.0

Data as of 7/01/2013. Source: Morningstar

(over please)

million in assets before a fund can start making a profit," he says.

The logistics of running a fund company are often enough to keep investment pros at their day jobs. Plus, there's the added complication of recruiting and overseeing employees. "Being a good manager of portfolios doesn't make you a good manager of people and businesses," says Russel Kinnel, Morningstar's director of mutual-fund research. For managers accustomed to the relatively single-minded task of investment research becoming a firm's head can be a tough transition.

And yet, despite all of the potential pitfalls of a start-up fund company, many proven managers take the plunge. Says Gardiner: "I think I knew 15 years ago that I eventually wanted to do my own thing."

For many, it's simply the need to scratch the entrepreneurial itch—to put into practice some of the things they've observed over the years. For others, it's about having control, both over the investment decisions and the size of the funds.

In the right hands, that can be a boon for investors. The kind of conviction and control that comes with funds run by firm founders is hard to match, says David Waddell, chief investment officer of Memphis-based Waddell & Associates. "They know that the success of the firm hinges on the success of the portfolio," he says, adding that it doesn't hurt that they've probably seeded the fund with their own money.

Investing too early in such a fund may have more risks than benefits. Expense ratios tend to be on the high side, even if the firm is covering some of the costs. There's also a gamble for investors who go in before the manager builds a track record on his own. "When you're an established asset-management firm, everything you need is down the hall," says Zucker. Take away the large research team, dedicated trading desk, and network of confidants, she adds, and the results might not be so impressive.

Then again, "There's nothing like owning your own business to understand what makes a good business," says Andrew Foster. The former portfolio manager and director of research at Matthews International Capital Management says he spends about a third of his time running his start-up firm, Seafarer Capital. "I don't see it as a distraction," he says. "I believe running my own firm has made me a better investor."

The four managers profiled here made a name for themselves at larger organizations and then struck out on their own, so far with strong results.

C.T. Fitzpatrick watched his employer grow from a small shop to a powerhouse firm—then he left to start his own company, Vulcan Value Partners.

C.T. Fitzpatrick, Vulcan Value Partners

Location: Birmingham, Ala.
Previous employer: Southeastern Asset Management, Longleaf Partners funds
Launched first mutual funds: 2010

In 2007, veteran value manager C.T. Fitzpatrick left Memphis-based Southeastern Asset Management, his employer for more than 17 years, moved back to his home state of Alabama, and spent nearly three years quietly building his asset-management firm, Vulcan Value Partners.

"I had some ideas I'd been fermenting and wanted to put them to work," says Fitzpatrick, 49, of his decision to leave after working alongside Mason Hawkins, manager of the $8 billion Longleaf Partners fund (LLPFX).

Launching an asset-management firm can be expensive, notes Fitzpatrick, particularly if you want to do it right. "You can do it on a shoestring, but if you want to have real systems and controls in place, the capital costs alone can exceed $1 million," says Fitzpatrick, who funded the venture with his own money along with backing from friends and family. "We wanted to be able to manage $10 billion on day one."

The firm isn't quite there, yet; it has roughly $2.4 billion in assets under management, most of it in separate accounts. But now that Fitzpatrick's two mutual funds have three-year track records—and good ones at that—word is getting out. The $504 million Vulcan Value Partners fund (VVPLX) is up an average of 20% annually over the past three years, better than 93% of other large growth funds. The $482 million Vulcan Value Partners Small Cap fund (VVPSX) has posted 23.7% annual gains in that period, better than 90% of its peers.

To get these numbers, Fitzpatrick abides by many of the same value-driven principles he honed at Southeastern. He buys stock with the intention of holding for five years or longer, insists on high free cash flow, and generally invests in a concentrated portfolio of 20 to 40 stocks in both the large-company and small-company funds. The key difference between his style and that of his former employer, he says, is that "we place as much emphasis on business quality as we do on the discount."

Many of his holdings are growth companies he had his eye on for years, waiting for just the right time to pounce. Case in point: NetSpend, which issues prepaid debit cards as a banking alternative, and was acquired by Total Systems Services (TSS) this year. Fitzpatrick was an early fan of NetSpend, but didn't move in until an earnings fumble sent growth investors scrambling for the doors. "When the stock blew up, we were paying attention," says Fitzpatrick, who initially bought NetSpend for his small-company fund at an average $5 a share in 2010; it was acquired at $16; Fitzpatrick sold soon after.

Another long-time holding is Donaldson (DCI), which makes heavy-duty air filters for the agriculture, manufacturing, and transportation industries. “Roughly half of their revenue comes from outside the U.S., and that portion of the business is growing quickly,” he says, adding that in many countries, demand for industrial filters is growing faster than gross domestic product. The company has managed double-digit earnings growth since Fitzpatrick first bought it five years ago. He has recently lightened up on the position, but will buy again if the stock stumbles, as he did when the shares fell 14% in a four-day period in 2011.

When it comes to taking a long and contrarian view, it’s helpful to be far removed from Wall Street, Fitzpatrick maintains. Perhaps surprisingly, recruiting new talent to Alabama hasn’t been a problem for the 19-person (and growing) firm. On the contrary, says Fitzpatrick, “People come here and say ‘I can live in a really nice place; it’s cheap; I can send my kids to good schools, and see the mountains.’ ”

Vulcan Value Partners Fund:
The Vulcan Value Partners Fund seeks to achieve long-term capital appreciation by investing primarily in mid- and large-capitalization U.S. companies believed to be both undervalued and possessing a sustainable competitive advantage.

Vulcan Value Partners Small Cap Fund:
The fund seeks to achieve long-term capital appreciation by investing primarily in small-capitalization U.S. companies believed to be both undervalued and possessing a sustainable competitive advantage.

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RISKS:
The Funds may invest in the securities of companies with small or medium market capitalizations. Small or medium-sized companies may have more limited product lines, markets, and financial resources than larger companies. In addition, their securities may trade less frequently and in more limited volume than those of larger companies. Small- or mid-cap stocks may be more volatile than those of larger companies and, where trading volume is thin, the ability to dispose of such securities may be more limited. Because the Vulcan Value Partners Small Cap Fund normally invests at least 80% of its equity assets in securities of smaller companies, these risks may be increased.

The S&P 500 Index is an unmanaged index of 500 common stocks chosen for market size, liquidity, and industry group representation. It is a market-value weighted index. The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values. The Russell 2000 Index includes the 2000 firms from the Russell 3000 Index with the smallest market capitalizations. The Russell 2000® Value Index measures the performance of those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. The S&P 500, Russell 1000® Value, Russell 2000® Value and Russell 2000® Index figures do not reflect any fees, expenses, or taxes. Investors cannot invest directly in an index.

	As of June 30, 2013			
Inception Date: December 30, 2009	Current Quarter	YTD	1 Year	Annualized Since Inception
Vulcan Value Partners Fund	**1.05%**	**11.23%**	**23.28%**	**14.03%**
Russell 1000 Value Index	3.20%	15.90%	25.32%	13.65%
S&P 500 Index	2.91%	13.82%	20.60%	13.06%
Vulcan Value Partners Small Cap Fund	**1.77%**	**17.82%**	**30.61%**	**20.27%**
Russell 2000 Value Index	2.47%	14.39%	24.77%	13.69%
Russell 2000 Index	3.08%	15.86%	24.21%	14.75%
*Total Expense Ratio Net: 1.25% Total Expense Ratio Gross: 1.51%				

The performance numbers shows the fund's historical performance. Past performance is not indicative of future results. Investment return and value of shares will fluctuate. Upon redemption, shares may be worth more or less than their original cost. The current performance may be higher or lower than the quoted performance. Vulcan Value Partners does not have a sales charge. Please call 1-877-421-5078, or visit our website, www.vulcanvaluepartners.com, for the most recent month-end performance results.

The holdings referenced in the article, NetSpend and Donaldson, had the following percentage of total net assets in the Vulcan Value Partners Small Cap Fund as of June 30, 2013, respectively: sold and 2.48%.

ALPS Distributors, Inc. is the distributor for the Vulcan Value Partners Fund, Vulcan Value Partners Small Cap Fund, Grandeur Peak Global Opportunities Fund and Seafarer Overseas Growth & Income Fund. ALPS Distributors, Inc. is not affiliated with LongLeaf Partners Fund or Southeastern Asset Management, Inc.

Please call 1-877-421-5078 to obtain a copy of the Prospectus, which should be read carefully before investing to learn about the investment objectives, risks, charges and expenses of the Vulcan Value Partners Fund and the Vulcan Value Partners Small Cap Fund.

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