Finding Quality and Growth at a Discount

Investing in well-established companies with growth characteristics tends to provide added value when the purchased stocks, or their sectors, are suffering from temporary problems. Steven Hill and Edwin Miska explain how the core strategy behind the First Investors Opportunity Fund blends a bottom-up selection process with a catalyst-driven approach to build a portfolio of quality stocks across a flexible market-cap range.

What is the history of the fund?

The First Investors Opportunity Fund was started on August 24, 1992 to take advantage of the strong growth opportunities offered by small- and mid-cap companies. Although the fund originally invested in firms manufacturing products in the United States, in 1998, this mandate was dropped. Foresters Investment Management Company, Inc. is the fund's investment adviser, and Steven Hill and I joined the firm in 2002 and now serve as co-portfolio managers.

The fund's market-cap range is fairly wide-ranging. It differs from traditional mid-cap funds because its broad mandate also allows us to invest in smaller-cap companies, although we pay little attention to the micro-cap space. Given the size of the fund, a certain level of liquidity is necessary and market caps between $1 billion and $15 billion provide a robust playing field. Typically, we don't go below $500 million, and the Lipper-defined definition of large-cap companies we use sets a ceiling at around $20 billion.

However, we don't necessarily sell stocks once they reach that large-cap mandate. If a company is quite successful and the stock keeps rising and performing well, we can continue to hold it through a full cycle and take advantage of that appreciation.

How do you define your investment philosophy and process?

We are a fundamental bottom-up investment firm and eschew market technicals. Although we do use quantitative analysis for screening and maintenance, we strive to understand the stocks in which we invest. This means our fundamental research extends far beyond merely reading financial statements, and ultimately allows us to form a long-term point of view on a company's investment prospects.

Our shareholder base is fairly conservative and long term so we've always used disciplined processes. We buy higher-quality companies than many other mutual funds, and look for those that are consistent in their results, and are able to grow their earnings, cash flow, and dividends, as well as have a focus on returning cash to their shareholders. Unprofitable companies have no place in the fund and are screened out.

These higher-quality companies may not outperform every year or in a shorter cycle. But over longer periods, they aren't dependent on the markets to generate the capital needed to execute plans, which should allow them to garner premium valuations over time, particularly if they get bought out, as many names in our portfolio do.

As a core fund, we don't have a bias toward either value or growth stocks. We emphasize catalysts, or the discrete events and/or moments in time that will lead to earnings acceleration or enhanced shareholder value. In other words, we look for companies with growth-like components and try to get them at a reasonable price.

We won't invest in early-stage biotech names or internet companies with price-to-earnings ratios of 100 to 300. Instead, it's our belief that earnings have a reasonable valuation that we can assign to them, with some variations by sector and perhaps even subsector. The fund is positioned as growth at a reasonable price, but our ideal

Edwin D. Miska
Director of Equities, Portfolio Manager

Edwin D. Miska, Director of Equities at Foresters Investment Management Company, Inc. ("FIMCO"), serves as the Portfolio Manager of the Growth & Income Fund, Life Series Growth & Income Fund, the Balanced Income Fund, Life Series Balanced Income Fund, Total Return Fund, Life Series Total Return Fund and serves as Co-Portfolio Manager of the Opportunity Fund and Life Series Opportunity Fund. Prior to joining FIMCO in 2002, Mr. Miska was a Senior Portfolio Manager and Managing Director of Evergreen Asset Management Corporation. He graduated cum laude from Boston University with a Bachelor of Arts degree in Political Science.

Steven S. Hill
Portfolio Manager

Steven S. Hill serves as Portfolio Manager of the Special Situations Fund and the Life Series Special Situations Fund and Co-Portfolio Manager of the Opportunity Fund and Life Series Opportunity Fund. He has served as Portfolio Manager of the Special Situations Funds since September 2013 and has served as either Portfolio Manager or Co-Portfolio Manager of the Opportunity Funds since 2004. Mr. Hill also serves as Portfolio Manager and Co-Portfolio Manager for other First Investors Funds and joined FIMCO in 2002 as an analyst.

definition of “reasonable price” means somewhat undervalued, rather than deep value.

Ultimately, our aim is to find stocks that are out of favor or have a temporarily depressed price due to a technical reason like a sector sell-off. When our interest is piqued, a fairly deliberate fundamental process is used to then evaluate whether something belongs in the portfolio.

What is your research process?

There are thousands of small- to mid-cap companies out there, which we eventually narrow down to just 20 to 30 interesting names using quantitative screening models, then layering on our valuation discipline and looking for an earnings growth inflection.

The quantitative tools we use vary by the market; for example, the one used in 2003 was most definitely not what we used in 2010. Today, even the latest Presidential election has led to modifications. Ideally, from among those thousands of companies, we want it to identify ones with forward price-to-earnings of less than the markets, and attractive price-earnings-to-growth of less than 1 times, typically – although recent trends have forced us to be more aggressive than usual because of the latest phase of bull market.

On a high level, we look at important metrics like positive earnings revisions and evidence that the next sequential or seasonal quarter is going to be up. To us, these signify an earnings inflection, meaning that earnings are starting to accelerate. We also look at liquidity and leverage ratios like net debt to EBITDA; although this varies somewhat by industry, a number greater than 5 is generally alarming.

Next, employing our disciplined valuation process, we look for an earnings growth inflection, which leaves us with 20 to 30 interesting names at any given point. We have a team of 14 investment professionals total, of which there are seven industry analysts who follow individual sectors. Several small- and mid-cap generalists supplement the analysts work, and help us with research; their job is to get in touch with the companies, go through all the public filings, and meet with the management to discuss their strategy.

Our analysts dive into the stories more deeply to figure out the growth strategies of these companies and what is behind their rising numbers. They analyze recent company results, market expectations, and how they have done relative to their own guidance. We typically won’t buy any new names without first having a meeting or phone conference with company management.

If this analysis points to a higher number than what the Street or the market might be expecting, or the possibility of a higher number based on the company’s explanation of what is going on – that’s what gets our attention and gives a stock the potential to be put in the portfolio.

Can you describe your research process with a few examples?

In May or June of last year, a company that popped up on our screens was VCA Inc, the animal healthcare company. Ironically, the name had always previously screened as expensive. We dispatched our analyst to see if there was in fact an earnings inflection – obviously, it had screened as such, but that was based on sell-side estimates.

We confirmed the inflection point through our own work. Essentially, VCA had made a hospital acquisition that didn’t work out as expected; the company had overpaid a bit and it was going to take longer than anticipated to get the cost of the hospital out.

Although management was cagey, we determined it had the potential for operating margin expansion over the next 12 months based on the company’s track record in prior acquisitions, which signaled an opportunity for us to invest. However, this past January, MARS, Incorporated acquired the company. It still worked out quite well for us: in just six months, we had approximately a 50% gain from our initial purchase.

Mergers and acquisitions (M&A) are an underlying theme among the companies we invest in – it’s something that underpins our thesis nine times out of ten. We analyze what a stock might be worth if a company were to be acquired, and if acquired, who the likely acquirers would be.

Since the financial crisis, mid- and small-cap companies have benefited from being domestically focused. They’ve taken advantage of extremely low rates to readily borrow money, and as well, they’re generating earnings and cash flow faster than many larger multinational companies.

Largely flush with capital and with the ability to borrow, many of our names have embarked upon merger strategies of their own. The rising earnings result from companies merging, rationalizing costs, and getting synergies on sales.

Newell Brands Inc exemplifies this M&A theme. The company, which markets a large portfolio of well-known consumer and commercial brands, successfully completed the merger of Newell Rubbermaid and Jarden Corp, another brand leader in consumer household products. The companies saw an opportunity to come together and take on the changing retail marketplace.

At the time of the merger, we owned positions in both companies, and both had been successful as individual investments. Since the deal closed in April 2016, the stock is up about 22%. Although a number of our holdings have benefited from an M&A strategy, none have quite reached this magnitude. Today, Newell remains one of the larger positions in our portfolio.

How do you go about constructing your portfolio?

We tend to construct our portfolio one stock at a time with a bottom-up focus. After going through multiple financial crises, we adopted a policy of broad diversification across sectors and in the number of holdings in the portfolio – thus meeting the needs of the conservative retail consumers who buy our fund.

At any given time, the fund has approximately 100-120 names. Positions are initiated at around 0.50% to 0.75% with the goal of them reaching 1% through appreciation. Possible additions to the portfolio are names we’ve identified as having the potential for 15% to 20% upside or more in a year.

The S&P MidCap 400 Index is our benchmark, but we also monitor the fund relative to the Russell Midcap Index and pay close attention to our peers in the Lipper Mid-Cap Core category on a daily basis.

We remain aware of overall sector weightings but don't pay too much attention to relative weighting versus an index or peer set. It's important to stay mindful of sector weightings, though, and generally we avoid dramatic underweights or overweights since we don't want the focus to be exclusively on stock selection as it could create a hidden risk force.

We have one-year price targets which are updated daily and constantly monitored. Changes are made based on information flow and any effect that may have on earnings and cash flow. As a name approaches our target, it will be reassessed and we'll decide if there is potentially more upside.

If we conclude that neither the valuation nor the catalyst for potential upside exists, we typically sell a stock. Sells can also be triggered by both positive events, like mergers, or on bad news as a defensive tool to protect the capital of our shareholders – perhaps there's been a management change, a strategy shift, or missed earnings that we can't make sense of because they're unexplained or poorly explained.

Typically, our holding period is longer than most. The fund's turnover ranges from 30% to 40% a year, which means we own our stocks for at least two to three years. Some names in the portfolio have been there since Steven and I got involved with the fund in the early 2000s.

What are the different risks you focus on? How do you control risk?

Our tendency is to focus more on risk at the level of the individual company rather than things like equity risk, the liquidity risks of small- and mid-cap companies, or the risk of a sector going out of favor. By relying on our bottom-up approach, we make long-term individual bets based on our ability to analyze companies over multiple years.

We constantly monitor this daily to see if there has been a change in the quality of the company, be it a deviation from a stated strategy, leverage that has increased uncomfortably, or a negative liquidity event which would compromise our ability to successfully trade.

One routine risk management tool we watch closely is position size – especially relative to our price target – to see whether a name has become a large position in the fund. Although we wouldn't necessarily eliminate the position, we would try to harvest some of its success and reduce the stock-specific risk that having such a large position introduces into the fund.

Managing risk from a macro perspective is something we try to avoid because so much of it is based on things beyond our control. We can't rely on the popular press to figure out which sectors or subsectors might benefit in a certain environment because almost invariably they are either wrong or simply lack the detail we need.

Take healthcare, for instance, where the risk situation changes every 24 hours. The circumstances are evolving rapidly, so we remain quite deliberate in our approach, because we are not rapid traders. Instead, we constantly assess what the outcomes could be, then make a decision to trade.

Even when we do trade, we tend not to go in and out of stocks but rather gradually accumulate and dispose of names over time to give ourselves leeway should there be volatility in the marketplace. T

First Investors Opportunity Fund

Adviser	Foresters Investment Management Company
Symbol	FIUSX (Class A)
Address	Foresters Financial 40 Wall Street New York, NY 10005
Phone	800-524-2803
Website	foresters.com

Source: Company Documents

About Ticker Q&A

Our research staff analyzes and selects funds based on their consistency in performance and durability of investment style.

You can find more fund profiles and view our other publications on Ticker.com and TickerFunds.com ticker

All investments involve risk, including possible loss of principal. You can lose money by investing in a fund. There is no guarantee that the Fund's investment objective will be achieved. The principal risks of investing in the Fund are: Exchange-Traded Funds, Market Risk, Mid-Size and Small-Size Company Risk, Sector Risk and Security Selection Risk. **Past performance is no guarantee of future results.**

S&P Mid-Cap 400 Index is an unmanaged capitalization-weighted index of 400 stocks designed to measure the performance of the mid-range sector of the U.S. stock market. Indexes are unmanaged and do not reflect the performance of any particular security.

Forward price-to-earnings is a measure of the price-to-earnings (P/E) ratio using forecasted earnings for the P/E calculation.

Price-to-earnings growth ratio is a valuation metric for determining the relative trade-off between the price of a stock, the earnings generated per share (EPS), and the company's expected growth. In general, the P/E ratio is higher for a company with a higher growth rate.

These views represent the opinions of the portfolio managers and are not intended as investment advice or to predict or depict the performance of any investment. These views are current only through the date stated at the top of the article, and are subject to change based on subsequent developments. We disclaim any responsibility to update such views. The Fund's portfolios and strategies are subject to change.

For more information about First Investors Funds from Foresters Financial Services, Inc., you may obtain a free prospectus and summary prospectus by contacting a Financial Services Representative, calling 800 524 2803 or visiting foresters.com. You should consider the investment objectives, risks, charges and expenses carefully before investing. The prospectus and summary prospectus contain this and other information about the funds, and should be read carefully before you invest or send money. An investment in these funds is not a bank deposit and is not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency. Neither Foresters Financial Services, Inc. nor its affiliates offer legal or tax advice. Please consult your tax adviser before making any tax-related retirement decisions.

Foresters Investment Management Company, Inc. | 40 Wall Street | New York, NY 10005 | 800 524 2803 | foresters.com

Foresters Financial

17-00544