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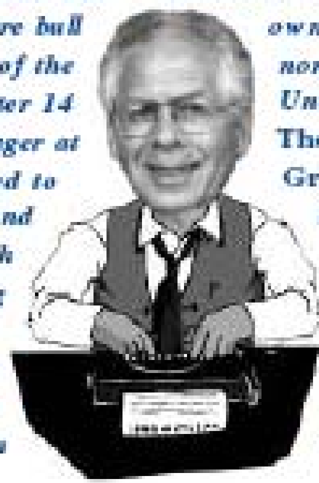
JULY 2006

The RUKEYSER INTERVIEW

Few growth-stock managers could match Frederick Kobrick in the 1990s. As Louis Rukeyser wrote in November 1999, Fred was "one of the finest managers of the entire bull market"; Peter Lynch calls him "one of the best stockpickers I have ever met." After 14 years as an analyst and portfolio manager at Wellington Management, Fred moved to State Street Research in 1985 and eventually ran State Street Research Capital Fund, one of the top-performing mid-cap-growth funds of the era.

In 1997 Fred started his own family of three funds, which produced huge gains in the late 1990s. He sold his firm in 1999 to Nvest, which in turn sold it to CDC, a French banking company. Since leaving the fund business in 2001, Fred has managed money on his own, provided investment advice to nonprofit organizations, taught at Boston University and, this year, written a book: **The Big Money: Seven Steps to Picking Great Stocks and Finding Financial Security** *(Simon & Schuster), a highly readable guide to investing in general and picking growth stocks in particular. Read on for this savvy investor's take on today's market—and what he likes now.*—Nikolas Lanyi, executive editor



An Old Pro's Model for Creating New Wealth

Fred, what do you make of the stock market's recent swoon and volatility?

Well, the stock market has been much more volatile in the past few years due to globalization and a greater sense of uncertainty on the part of investors. So I think volatility is normal, but if people truly know how to identify the right stocks it gives them an advantage.

Obviously, for the past two months we've had the issue about what the Federal Reserve is going to do, and we've had the issue of what's going to happen with oil. But investors often get trapped into making the wrong moves by trying to forecast the market and galactic events rather than what they really can forecast: great companies and great stocks.

The great economist Paul Samuelson once quipped that the stock market has forecast nine out of the past five recessions. Market timing and forecasting costs people the ability to get wealthy, since they take actions that remove them from stocks that could make them wealthy for life. I think people should be long-term investors and buy great companies that can in some cases multiply their money very nicely, better than ordinary returns. The best stocks possible, historically, have multiplied money by 50 to 600 times. I think people should be looking for those kinds of stocks and never chicken out on them because of near-term market uncertainty.

The title of your book mentions "seven steps to picking great stocks and finding financial security." Can you summarize them?

The leadoff step is knowledge, and that's by far the most important. Most people really don't understand what they own. The four parts of knowledge for identifying wealth stocks are what I call "BASM": business model, assumptions, strategy and management.

The rest of the steps really work together seamlessly, like your arms and legs when you're running. Patience, discipline, emotions and avoiding market timing are all parts of it. The other ones are benchmarks and time horizon.

Even beginning investors can do this: be methodical, know what you own, have patience, know how to hold what you own and how to sell when things are not meeting benchmarks.

When it comes to knowledge, the biggest problem individual investors face is that they are overwhelmed by the information superhighway, and they have no focus. When little kids learn how to ride a bike, they're intimidated because they have no idea how to stop themselves from falling off. But the reason they don't fall off is that everyone is born with a sense of balance. I think that if people focus and use common sense, the simple things that make for great investors will be very apparent to them.

A lot of people who buy stocks just look at numbers—I call them "mathletes." But they often don't know what creates the numbers. That's why I say that although the golden eggs are earnings, and that's what drives stock prices, the goose that lays those golden eggs is BASM.

Applying these principles to the market today, what stocks do you find most attractive?

FIVE FROM FRED

Stock (Symbol)	Recent Price	52-Week High/Low	Earnings 2005/2006*
Sirius Satellite Radio (SIRI)	$4.01	$7.98/$3.60	–$0.65/–$0.81
Yahoo (YHOO)	30.60	43.66/28.60	0.58/0.55
Garmin (GRMN)	93.22	101.88/41.04	2.85/3.56
NAVTEQ (NVT)	43.17	55.86/34.55	0.96/1.21
iRobot (IRBT)	23.58	37.90/20.50	0.11/0.04

*Estimates. **Source:** Bloomberg, Zacks.

We always look at young companies, which can multiply money by huge amounts. *Sirius Satellite Radio* is one that reminds me of the good things, and also the doubters, back in the days when cell phones and cable TV came into being. People thought these were going to be small niche markets. I like Sirius because I think satellite radio is not only a brand-new emerging market that's growing very nicely—partially because [broadcast] radio has become too standardized, with cookie-cutter programming—but also because Sirius' management is led by Mel Karmazin. He grew up in radio, ultimately became chairman of CBS; I've known him since that time. When CBS was acquired by Viacom he co-ran Viacom, and now he's the chairman of Sirius. I think he's the grand master. Second, because of him and the quality of their business model, they are now growing far faster than the original leader, XM Satellite Radio. I like XM, because I like the field, and there are only two companies. But Sirius is taking market share by leaps and bounds.

By the way, that is one of the all-time great measures of a great company: a company in an emerging field that comes from behind and takes market share from the former leader. Nike, Microsoft, Home Depot and Sun Microsystems all came from behind. I remember Apollo Computer, which made one of the first and best workstations for corporations; Sun Microsystems came along and beat them by constructing a business model based on what customers wanted, not only today but tomorrow—whereas Apollo was very cocky. You can't just compete with hot products; you have to compete with hot business models and hot strategies. That's what wins the game.

Another great example: when Bill Gates came along, he was seen as a guy who could see the future, like some sort of magician. But really he just carefully constructed a business model. Lotus had 70% of the spreadsheet market, and everyone was saying "game over." But Bill Gates sat down and studied how people and corporations wanted to buy software. And by really understanding how people behave, he then constructed a great business model from the assumptions. That's how he won. What you really need is repeatability, and the engine of repeatability is your business model.

There's another great fight going on right now among Microsoft, Yahoo and Google. All of them are going to come out with hot new products, and some people will get blinded by that. But investors should focus on the business model. And so far, between Yahoo and Google, I think *Yahoo* has the better business model. They did something like what Bill Gates did: Yahoo thought a lot about what people come to an Internet portal for—what's in it, how it should be arranged and how people use it. As a result, they are the most popular site, with the most registered users. The product flows from the business model.

I also like *Garmin Ltd.*, which makes global positioning systems [GPS]. When I first started looking at GPS, Magellan was the leader, and Garmin, through its technology, its business model and the excellent products that they have for each of the segments— handheld, aircraft and automotive, and so forth—is now showing great leadership capabilities.

A related company is *NAVTEQ*, which provides digital map information for automotive navigation systems. This is a great way to invest in the burgeoning market for mapping and navigation. They run in a huge percentage of the cars produced in North America. They are the masters of the technology. They're in a key market and demonstrate that they can do a phenomenal job.

There's another stock I think has a lot of potential, but I want to couch it with one caveat. In an emerging field, companies have to prove themselves for a while—then you keep the ones you like and weed out the ones that don't work. Having said that, I really like a company called *iRobot*. I think that robotics is going to be a very big deal. This company is known for its popular product called Roomba, the home vacuum cleaner; they've sold more than two million. But a lot of people don't know that iRobot is the leader in highly technical robots for the Defense Department. They perform a lot of functions that are dangerous to humans, like disarming explosives and even intelligence work. This is going to be extremely useful in everything from outer space to deep-sea ocean to mining. I like the way this company is performing, and they have a great consumer product that helps fund the research in other areas.

Finally, Fred, what's your single best piece of advice for investors over the next 12 months?

Ralph Waldo Emerson said, "Knowledge is the antidote to fear." Let knowledge overwhelm your emotions instead of the other way around. ■

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