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THE BOND BUYER

Manager Goes Far & Wide in Quest for Risk-Adjusted Returns

By Elizabeth Roy | 06-03-1996

Striving for the highest possible risk-adjusted performance takes B. Clark Stamper to corners of the municipal market that are rarely visited by other portfolio managers, he says.

Stamper, president of Stamper Capital & Investments Inc. in Monterey, Calif., and manager of the $160 million Davis Tax-Free High Income Fund, likes to frequent the housing, health care, and industrial revenue sectors.

He approaches issues in those sectors that are haunted by the specter of bankruptcy or taxability and are thus trading cheaply, in search of the ones that seem likely not only to survive but also to prosper.

He calls them "emerging growth municipals."

Deals the fund has benefited from recently have involved tax-exempt debt from such troubled corporate entities as general contractor Morrison Knudsen Corp., and such uncertain tax situations as bonds backed by the federal government's Resolution Trust Corp.

In each case, Stamper made it his business to know something about the bonds that the mass of investors did not bother to find out. And his research efforts were rewarded, he said often in a matter of weeks.

The basic principle, Stamper said, is to identify issues that offer the highest yield for the amount of credit or interest rate risk they carry.

Tricky Features

The hard part is assessing the risks. The high-yield bonds Stamper looks at often have features such as puts, calls, or sinking funds attached to them, making them tricky to evaluate.

In many cases the bonds are nonrated, so no rating agency has examined them. Sometimes, neither has any brokerage house.

The market "inefficiencies" caused by lack of information, however, are Stamper's bread and butter.

Through his own research and through his ability as the fund's sole manager, analyst, and trader to "react on a dime" Stamper says he finds the issues that offer the improbable combination of low volatility and high income.

Last week, the fund's average maturity was 15.7 years, but because its average coupon is over 8% and because many of the bonds are callable, its duration was only about five years.

That combination of low volatility and high income makes the fund one of just 11 high-yield municipal funds to carry a five-star rating from Morningstar Inc.

Low volatility is also achieved through diversification, Stamper said.

Because the fund contains more than 300 issues, "one or two mistakes don't affect the value," he said. Neither, unfortunately, do "one or two home runs," he added.

Stamper began managing the fund in June 1990 when he joined Selected/Venture Advisers Inc. in Santa Fe, N.M. It was then known as Venture Muni Plus.

He also ran a taxable high-yield and two mortgage-backed funds for the firm, which changed its name to Davis Selected Advisers last Oct. 1.

Coincidentally, Stamper last October left Venture to form his own company, but he continues to manage the two high-yield funds as their sub-adviser.

Junk Bond Specialist

Stamper's background as a junk bond specialist which stretches back all the way to 1987, when he started analyzing the bonds for a savings and loan gives him an edge in the world of high-yield municipals, he says.

Much high-yield municipal debt is backed by corporate issuers of junk bonds, or by similar corporate entities, he explained "A lot of people don't do their own credit research, or if they do it, they only look at companies where they have reports from other brokers," Stamper said.

"I come out of the junk bond area, and I'm pretty comfortable doing my own research.

"I buy a lot of issues that aren't researched, and there's not reports by anybody else."

Stamper's recent purchase of a block of industrial revenue bonds issued by San Diego Port Facilities illustrates both his search for the combination of high income and low volatility and his skills as a corporate analyst.

Because Morrison Knudsen, which is on the verge of prepackaged bankruptcy, is the primary guarantor on the bonds, the mass of investors shunned them.

Stamper bought the bonds for a "huge" tax-free yield to maturity of 8.62% - down about 10 points from where they would have traded had Morrison Knudsen been in good financial health.

The bonds, which are backed by lease payments, are also guaranteed by San Diego-based National Steel & Shipbuilding Co., Stamper explained.

But initially, neither the financial health of that firm nor the relative strength of its guarantee was clear, he said. Unlike Morrison Knudsen, National Steel & Shipbuilding is not publicly traded, so information about it is hard to come by.

With the help of the broker who was showing him the bonds, Stamper obtained financial information about the shipbuilding firm.

"I did a lot of checking and found out National was fairly strong, and sales and cash flow were improving year over year," he said.

Also, some of its competitors in the state had closed down, "making them even stronger their backlog was growing," Stamper said.

In addition, the legal documents were written in such a way that "it was very hard to tell exactly who was on the hook," he noted.

"You had to read a lot of documents to tell whether the lease payments were guaranteed by both Morrison Knudsen and by National, and it turns out they were," he said.

Furthermore, the bonds carried a put under which they would go up to par in the event of a bankruptcy, but it was not clear whether just one or both of the guarantors had to be in bankruptcy, Stamper said.

Again, by studying documents he determined that only one bankruptcy filing was necessary.

Shortly after Stamper bought the bonds, "everyone else found out the same thing" about their quality, he said. Over two weeks, the bonds have risen 10 points, back up to par.

Overall, Stamper thought the deal offered "superior yield per credit quality, or superior upside potential versus downside protection."

The put provided the upside potential, while the mortgage backing deal limited the downside, he explained.

"That's pretty much what I try to do on all the investments in the fund," he said.

To manage interest rate risk, as opposed to credit risk, Stamper follows certain yield spreads.

For example, several times in the last five years he has bought and sold housing bonds backed by Resolution Trust Strips which are at risk of becoming taxable.

Stamper trades the bonds based purely on their yield ratio to Treasuries.

He buys them at 100% of Treasuries "that's probably when the market's bottoming," he said and sells them at 90% to 95%, "when the market's probably topping out."

With no credit risk since the bonds are government-backed and triple-A rated, Stamper explained, "It's a pure interest rate play."

Cushion Bonds

A measure of market-calling also goes into Stamper's strategy. For example, when he thinks the market is nearing a high as he did, correctly, at the end of last year Stamper buys cushion bonds with short calls.

He bought 8% coupon bonds with calls trading at 102 at a time when comparable noncallables were trading at 110.

As prices have fallen so far this year, the callables have held more of their value, trading down just one or two points, according to Stamper.

He focuses more on credit risk than on interest rate risk because, he says, that is where his skills are most productive.

"I'm not trying to take that much market risk," he said. "Anyone can go out there and take market risk.

"I think the portfolio manager adds a lot of value if he can achieve the same kind of total returns with market-insensitive positions."

Price appreciation potential is nice, Stamper conceded. But he will not pursue it at the expense of income protection from rising rates.

"I'll give up some upside potential to pick up a lot of downside protection," he said.

Because of its focus on income, the fund lags in bull markets like last year's. In fact, the fund came in dead last among high-yield portfolios in 1995, according to Lipper Analytical Services Inc. It's a shares returned 8.78% and the B shares returned 7.85% in a year when 38 high-yield municipal funds had an average total return of 15.98%.

But in bear markets like this year's so far, the fund goes to the head of the class.

For the year through April 30, it's A shares ranked first, the B shares second, among 44 high-yield funds with an average total return of 1.98%. They returned 0.77% and 0.44%, respectively.

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Stamper Capital & Investments, Inc. has been the sub-adviser to this Fund since October 1995 and B. Clark Stamper, our President, has been its Portfolio Manager since June 1990.

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