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Lee Emmert for Barron's

Interview with Carl W. Marker

President and Chief Investment Officer
IMS Capital Management

At Home On The Rapids

Oregonian Carl W. Marker founded his money-management firm, IMS Capital Management, 18 years ago and has managed the top-ranked mid-cap **IMS Capital Value Fund** since its 1996 inception.

Explain your overarching strategy for IMS Capital Value Fund and why it is so important to your thinking.

I invest in undervalued mid-cap stocks in fast-moving streams with seasoning and positive momentum in the stock price. That's what separates us from other managers. Most value managers buy stocks too early. We try to be patient, by waiting for the share price to get some positive momentum. Most value managers don't focus on where the growth is.

Traditional value managers sit on dead money; they focus on low price-to-equity industries like basic materials, capital goods, companies that have been beaten up and post slower growth.

By day, you're a cautious mutual-fund manager, so is that why in your off-hours, you like to take more risk?

I spend my time at the office trying to reduce risk, so in my personal life I like to blow off steam riding motorcycles, like an 1100 Honda Shadow street bike and a dirt bike, as well as snowboarding and taking my kids rafting on Portland's nearby Clackamas River.

Let's just say I spend my time in fast-moving streams. Unlike other value managers, we don't look in slow-moving water, like ponds and lakes. We like companies on the move, in industries that are high-growth. That's how we invest, and how I recreate.

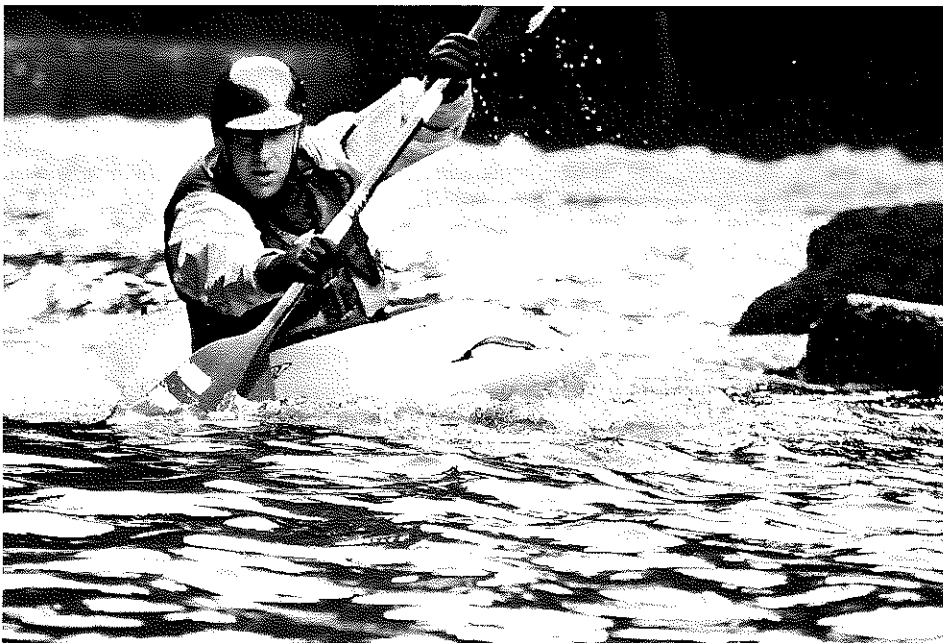
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DOWJONES

Plying Fast-Moving Streams

By Erin E. Arvedlund



Lee Emmert for Barron's

A lover of outdoor adventure, Carl W. Marker quit a corporate job to establish IMS Capital Management, where he combines the philosophies of value and positive-momentum investing.

"EVER SINCE I WAS A KID, I WAS A CAPITALIST," says Carl W. Marker, founder, president and chief investment officer of Portland, Ore.-based IMS Capital Management.

Growing up in Portland, Marker says, he was always fascinated by the challenge of making money. As a 10-year-old, he picked and sold fruit from his parents' yard, collected aluminum cans and glass bottles to earn recycling money and had a newspaper route. At 14, he bought an old boat, motor and trailer for \$400, fixed them up and sold the whole lot six months later for \$800—and that was in 1968 dollars.

"That convinced me that mispricing is rampant in the marketplace," Marker recalls. "You have to buy something at the right time, put a little effort into it and later sell it for considerably more. The lesson for me was that value is in the eye of the beholder. It's not necessarily worth what the seller says."

At 16, Marker inherited a few shares of GTE stock from his grandparents, and began following the markets while still in high school. He majored in computer science at college, but took business and fi-

nance classes on the side.

In 1988, at the age of 25, he founded IMS Capital Management, beginning with no assets except money given to him to manage by a few friends and family members. By 1996, he had opened his first mutual fund, the **IMS Capital Value Fund** (ticker: IMSCX), the firm's flagship. By 2000, he had \$50 million in assets under management, including three mutual funds. Today, IMS oversees \$800 million.

Marker credits a love of markets for his success, as well as his wife of 20 years, who supported him after he quit a corporate job to start the business. White-water kayaking also taught him discipline and recovery—"how to roll and come back up. Little by little, I started kayaking on bigger and more intense rivers," first in Oregon, then in Costa Rica, Zambia and, soon, Argentina, he says.

But Marker doesn't take risks at the office. A conservative and traditional value investor, he points out that his returns held up between 2000 and 2002, when U.S. stocks suffered one of the worst bear markets since the Great De-

pression: The Nasdaq plunged 66% and the Standard & Poor's 500 index tumbled 40% in that period, while Marker's value fund was up slightly over those three years.

The stock market turned around just after U.S. tanks rolled into Iraq in 2003, and IMS continued forging ahead. In 2005, IMS Capital Value returned 10.5%, ahead of its Morningstar category by 1.3 percentage points and the Standard & Poor's 500 by 5.6 percentage points.

Unlike other value managers, for IMS Capital Value he considers a factor that he calls "positive momentum" when buying stocks, in order to reduce risk. "When you buy too early, oftentimes a cheap stock gets even cheaper," he explains. "When a stock drops from 60 to 40 to 20, that's risky to me, and clients lose money."

Positive momentum—whether in the stock price, earnings, corporate developments or some other good news—is one of Marker's pillars of investing. He also looks for stocks that are undervalued relative to their historical averages, and for seasoned companies (no start-ups) in a "fast-moving stream"—meaning growth businesses.

Marker underweights utilities, basic-materials stocks and capital-goods companies. Fifty years of market data, he argues, show those sectors aren't among those producing the highest returns.

He screens for mid-cap stocks, usually with market capitalizations between \$2 billion and \$10 billion that have fallen at least 30% from their all-time highs. He also likes stocks trading at historically low price-earnings multiples and other ratios—for the companies as well as for their industries.

One example: **H&R Block** (HRB).

"There's no industry per se," Marker points out. "They are the industry. They could be compared to banks, but they're a different animal. So we want to buy H&R Block when it is undervalued against its own record, as well as looking for price-to-earnings growth ratios of under 1.5." The ratio compares the P/E with the growth rate of the company; the lower the better, the higher it is, the more expensive the stock is.

Among the sectors Marker regularly paddles in are those he estimates have produced the highest returns: technology, health care, financial services, consumer durables and nondurables lumped together, and an old sector once called communications and now classified as communications/entertainment/leisure. He also likes industries that are consolidating and have strong growth prospects.

Marker also plies mid-cap waters because, over the long haul, they have turned in stronger returns than small- and large-caps, and with lower volatility, according to Morningstar data. Mid-cap stocks beat small- and large-caps over the past 10 and 15 years, although not in the past five, when small-caps pulled ahead slightly, he notes.

Mid-caps "possess the best of both worlds: high-growth entrepreneurial companies with proven management and products, plus the international scope of large companies," he says. Moreover, mid-caps get bought out frequently, and Marker observes that, each year, about 10% of his portfolio's holdings are taken over by large-cap buyers.

Examples from past years include Pennzoil and Quaker State, Boise Cascade buying OfficeMax, Adolph Coors and Niagara Mohawk. **IMS Capital Value** fund is currently a shareholder of **King Pharmaceuticals** (KG) and **Computer Sciences** (CSC), both recent recipients of buyout bids, though neither has yet come to fruition.

If Marker's strategy sounds a bit like a blend between growth and value, he says that's true—especially when it comes to selling discipline: "When we're right and a stock goes up in price, we don't sell unless it loses momentum in some way; only then do we take some off the table. We're relative value—not deep contrarian. We buy value that has positive momentum, not at absolute bottom. We wait until it starts coming back up."

Tellabs (TLAB) is a company in one of Marker's "fast-moving streams"—technology and communications equipment, where few value managers ventured. The company had a lot of cash on the books and strong earnings momentum when IMS started buying it last year for the Value fund at an average cost of \$9.12 a share, and he continues to add to the fund's position. Marker's target price on the stock is \$20; the shares were chang-

IMS Capital Value Top Ten Holdings

Company	Ticker	% of Portfolio
Service Corp Intl	SCI	3.45%
E*Trade Financial	ET	3.39
King Pharmaceuticals	KG	3.02
Aon	AOC	2.79
Lincoln National	LNC	2.77
OmniVision Technologies	OVTI	2.75
Lucent Technologies	LU	2.75
Equifax	EFX	2.32
Nationwide Finl Services	NFS	2.31
Computer Sciences	CSC	2.29
Total		27.84

As of Dec. 31.

Source: Morningstar

ing hands late last week at more than 11.

From \$77 a share in 2000, Tellabs stock fell to as low as \$5. In line with his positive-momentum strategy, Marker didn't buy it at the bottom, instead waiting for some upside earnings surprises and revisions to estimates. "The company has literally no debt, improving margins and positive relative strength versus the market," he says. "The stock market hasn't doubled since 2002, but the stock has."

Marker said he was patient, noting that he could have bought at the end of 2003, when the stock went up to 17 and then came back down to the single digits.

"It was a head fake," he recalls. "It takes at least two years or more to resolve problems, get earnings back on track and earn the confidence of Wall Street. In 2003, nothing much had changed."

Humana (HUM), for instance, falls into several slots Marker likes. It's a health-care stock in an industry that holds up well in bear markets and is in the midst of consolidating—all positive-momentum signs. In 2002, the stock had been down for five years, and IMS started buying, accumulating a position with an average cost basis of \$16 a share. Early this year, he sold half the fund's stake at \$46 a share.

Marker's sell discipline is double-barreled. He gets out if the stock exceeds his price target and starts losing momentum, which means he often rides the wave up longer than most value managers would. "We don't sell if there are still concrete reasons that sales are good," he explains. "Most value managers have already sold

Humana, which trades at an all-time high at a trailing P/E of 25."

One of IMS Capital Value's top holdings is **E*Trade**, the discount-brokerage firm that Marker began buying last year. E*Trade (ET) had fallen from 50 to \$10 a share, had started reporting positive earnings surprises, gotten into the mortgage business and improved trading volumes.

Service Corp. International is the fund's largest holding since mid-2005. Marker started buying it in mid-2003, when the stock had fallen from \$50 into single digits. The fund's cost basis is \$5 a share, and he says the company's funeral-services business "holds up well in a down market, has recently had positive earnings surprises and is reducing debt. We like that."

Service Corp. (SCI) "had a nasty accounting scandal in the late 'Nineties, which left a bad taste on Wall Street. But this company is beautifully positioned in terms of America's aging demographics. Baby boomers, the country's largest population segment, are now all turning 60. There is going to be a lot more demand for Service Corp.'s services over the next five years." IMS Capital Value has held Service Corp. for three years, although the share price has moved only from 5 to 8. Marker's target price is 15 to 20.

The fund also owns **Gentiva Health Services** (GTIV), the country's largest provider of home health care, another play on the U.S. aging population. As growing numbers of affluent Americans become senior citizens, they can afford home health care instead of nursing homes. Hospitals, individuals and assisted-living concerns are hiring Gentiva, and Marker believes the company will be taken over by a large health-maintenance organization or hospital chain.

Finally, this value manager recently unloaded shares in **Loews** (LTR), which he describes as one of the last true conglomerates—with businesses in tobacco, insurance, hotels, watches and natural gas-pipelines.

Marker started buying the stock at around 42 a share, and sold at 97 in November. "It blew through our price target of 65," he says, "partly on the strength of its natural-gas pipelines." ■

ERIN E. ARVEDLUND is a free-lance writer, living in New York.