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A Good Mutual Fund Expands Its Horizons

Fund Spy | 07-07-09 | By Gregg Wolper

It could be removing its handcuffs, or it could be overreaching.

At the end of June, the fund then known as Principal West Coast Equity changed in a major way. It had been required to choose its stocks primarily from the region in its name; specifically, the firms had to have their headquarters in California, Oregon, Washington, or Alaska, or have the majority of their employees in those states. Now, it has a new name—Principal Capital Appreciation (CMNWX)—and can invest all over the country.

That would be of minimal interest except that this is quite a good fund, with a strong record, reasonable cost, and long-tenured manager. In fact, its regional limitation was about the only strike against it. It was tough to get strongly behind a fund with a more-or-less random mandate (the four states don't have much in common beside the Pacific Ocean), which itself had changed over time. It didn't qualify as a core fund, yet with a straightforward all-cap blend or growth portfolio, it didn't fit into the supplemental camp, like a technology or emerging-markets offering, either.

Go Out and See the Country

Last week, the fund dispensed with its West Coast limitation. Now, manager Phil Foreman can invest all over the United States. Other than that, though, he'll use the same strategy that has given the fund strong performance for years. (He's been managing the fund since early 2002, but also worked on it in the 1990s, when it had slightly different mandates—it focused only on the Northwest, excluding California, and for a time it used a passive approach.)

During Foreman's current tenure, the fund has trounced the large-blend and large-growth category averages as well as the S&P 500 Index. It's also ahead of the mid-blend category average, though by a much smaller margin. The comparison to the mid-blend average is relevant because the fund has always owned a substantial amount of midsize and smaller companies, though the overall portfolio has landed in the large-cap section of the Morningstar Style Box for years now.

Broader Can Be Better

There are two main benefits of the fund's expanded mandate. First, and most obviously, Foreman now can own any company he wants, without checking the map first. He was always allowed to own some stocks outside of the West Coast—which means his new field isn't entirely foreign territory—but only a fairly small amount. Now the non-Western stake is unlimited.

Second, the fund will no longer necessarily have skewed sector weightings. Partly because he liked the companies that he found, but also because of the makeup of the region's corporate universe, the fund typically has owned larger stakes in the software and forest-products fields and had less exposure to media stocks than most national funds did. If he wants to, Foreman can continue to hold those—or other—unusual sector weightings, but such decisions will be driven entirely by choice rather than by a geographical restriction.

Not So Fast?

Of course, there's no guarantee that this change will work to the fund's advantage. After all, it's possible that in restricting Foreman's field of vision, the fund's former mandate forced him to become so familiar with the companies on his map that he had an advantage over managers with a much broader landscape to study. Although a regional focus can be a gimmick providing no benefit at all—such funds have come and gone over the years—the idea that it can convey an advantage isn't just a dream. A regional bias seems to account at least partly for the long-term success of Mairs & Power Growth (MPGFX). The managers of that low-key, Minnesota-based fund have always filled the bulk of their compact portfolio with companies headquartered either in Minnesota or in nearby states such as Wisconsin, Iowa, and South Dakota.

However, if I had to guess, it seems likely that Foreman will select companies from the rest of the country just as effectively as he has evaluated those in states bordering the Pacific Ocean. And it's not as if he's required to sell all of his current favorites. If he really does know

West Coast companies better than other managers do, he can continue to own those that he likes and shun the rest, and thus maintain that local advantage.

A Story to Watch

This isn't meant to encourage you to jump up and buy this fund right now. Rather, it's a heads-up. It's quite rare that a regionally focused fund has racked up the kind of record this one has posted, with an experienced manager and a reasonable cost to boot. It's even more unusual for a regional fund with such attributes to abandon that mandate and go national. Watching its course will be worth the effort for anyone interested in investing.

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