

Triumph of the Cheapskate

by Jack Willoughby

(The following has been excerpted.)

Dan Fuss would be the right guy to have by your side if you were haggling with a new-car salesman. The 78-year-old vice chairman of the Boston-based Loomis Sayles investment firm is downright crazed about getting a good price for whatever he buys.

Says Fuss, who also is senior portfolio manager of the Loomis Sayles Bond Fund (ticker: LSBRX for retail shares, LSBDX for institutional ones): "We buy bonds as if we were going to hold them for four or five years," meaning that he tries to acquire them so cheaply that both income and net-asset values rise over time.

The portfolio chief, whom many bond-market observers rank with Pimco's Bill Gross and DoubleLine Capital's Jeffrey Gundlach as today's premier fixed-income investors, acknowledges that "in bonds, that's no mean trick, particularly with rates going down . . . The results show that we do not correlate with anyone's average bond-market index. It's all about selection. . . Our strength is credit analysis. We deal in specific risk, not market risk. . . Loomis Sayles at its core is a rock-solid research firm."

Fuss, who came to Loomis from the Boston Co. in 1976, when the modern mutual-fund industry was in its relative infancy, views money management as a craft as much as a science.

The Wisconsin native's career began with a long apprenticeship under business leaders in Milwaukee and on the East Coast. He briefly ran Yale's endowment fund, where he worked with William McChesney Martin, the former New York Stock Exchange president and longstanding chairman of the Federal Reserve Board. Martin, he recalls, "was invaluable in explaining to me the broad picture. We stayed in contact over the years for breakfast at the University Club in New York."

Since starting the Loomis Sayles Bond Fund in 1991, Fuss has turned it into a giant. The \$19.2 billion in the fund's 132,000 accounts represents 12% of all the assets that Loomis Sayles manages.

The fund's growth has been fueled by performance—it has generated a 9.82% average annual



Jason Grow for Barron's

Fuss says of his bond group at Loomis Sayles: "We deal in specific risk, not market risk."

(over please)

return since inception—and Fuss’s ability to inspire confidence in potential shareholders, ranging from small investors to professional money managers.

Last year, Loomis Sayles Bond, which has an 0.94% expense ratio for its retail shares, had a total return of 3.48%, placing it about midpack among the funds in Morningstar’s multisector bond category. Over five years, its average yearly return was 6.22%, better than 67% of its peers. And over 10 years, its return averaged 9.71%, besting 88% of its rivals. (The figures are for the retail shares, but the results for the institutional shares are essentially the same.) The fund’s go-anywhere mandate lets Fuss explore all forms of debt securities, including collateralized mortgage obligations, bank loans, government securities, preferred stock, common shares and foreign securities.

His specialty is buying out-of-favor issues, and selling them after the storm has passed. Bond Fund’s recent purchase of Republic of Ireland 4.5% due on June 1, 2018, could fall into this category.

The fund also has a reputation as a place where institutions can quietly unload unwanted issues.

Fuss’s long experience in weighing the motives of, and pressures on, the institutional bond holders on the other side of the bargaining table helps him determine which of these issues to buy and which to avoid. He won’t touch a security unless his value team has thoroughly examined it. The team includes portfolio managers Kathleen Gaffney, Elaine Stokes, and Matthew Eagan, plus about 40 credit analysts, a group split between investment-grade and high-yield specialists. Fuss makes his judgments only after they have “carefully studied the issuer, the security and its place in the capital structure.”

Many of Fuss’s relatives have invested in his funds. He loves to tell the story

of one Thanksgiving when he returned to his home in Wellesley, Mass., for dinner, only to find his wife, RoseMary, berating him for being late on this family occasion. Fuss’s father-in-law, a Bond Fund shareholder, had already started digging into the turkey with gusto. He pulled a drumstick from his mouth and chided his daughter: “Rose, Let the man work.” Jokes Fuss: “It’s a tremendous advantage if you have family in the fund. They don’t get on your case when you work late.”

Fuss eats lots of his own cooking. He says he holds more than \$10 million in Bond Fund and other Loomis Sayles offerings.

Of course, Fuss has had his share of down years on Wall Street. The worst in recent memory was 2008, when the financial crisis was peaking and Loomis Sayles Bond lost 22.12%. Large outflows shrank it to \$12.5 billion. In 2009, however, the fund bounced back with a 36.8% return. Fuss was elected Bond Manager of the Year by Morningstar—in essence, going from chump to champ in just 12 months. “I tell my clients: Same bonds, new prices,” says the money manager. “You can’t measure your success by quotes. Unlike stocks, bond quotes have little to do with fundamentals.”

Currently, one of the Fuss team’s favorite issues is the Ford Motor 4.25% due Nov. 15, 2016. The auto maker has come back from the brink of disaster with strong profits, a bolstered balance sheet and a new vehicle lineup that helped its sales jump 11% last year.

Fuss also likes bonds issued by some Canadian provinces and municipalities, whose finances generally are in better shape than those of their U.S. counterparts. Canada has “a younger population than the U.S. and positive net immigration. . . . The thing I really appreciate about that country is when they write a debenture,

it means what it says, no sneaky calls,” he says.

The current fear of financials offers plentiful opportunities for investors in bank debt, in his view. More stringent capital requirements that take effect in 2013 are forcing bankers to beef up their capital and dump some securities. “The problem with banks is what people think of them; they don’t trust them. Never mind the public. Other bankers don’t trust other banks because they know the weaknesses contained in their own balance sheets,” says Fuss. “This is a particular problem in Europe.”

Another way to play the financial sector, Fuss observes, is to buy bonds of big banks considered too big to fail, but nonetheless out of favor. While some investors are worried about Bank of America, Fuss isn’t, at least for the long term. The Loomis Sayles Bond Fund recently bought some BofA 7% due in 2019 that yield 8%.

All in all, Fuss has traveled far from his beginnings as the son of a telephone-company workman from Milwaukee.

It wasn’t until he returned from the Navy, married for the first time and had established himself as the assistant to Art Kohaske, president of Wisconsin’s Wauwatosa State Bank, that he really learned the craft of money management. Fuss studied the bank’s bond holdings and briefed Kohaske on them every afternoon. These discussions—along with a finance degree he earned in night school at Marquette University—gave Fuss insight into the art and the feel of managing other people’s money.

In fact, Fuss says, the daily question-and-answer sessions taught him more than he ever learned in the classroom. Loomis Sayles Bond Fund investors are still profiting from those lessons.

Fund Risk: Because the fund can invest a significant percentage of assets in foreign securities, the value of the fund shares can be adversely affected by changes in currency exchange rates, political, and economic developments. In emerging markets these risks can be significant. The fund is subject to currency risk, which is the risk that fluctuations in exchange rates between the U.S. dollar and foreign currencies may cause the value of a fund's investments to decline. Funds that invest in securities denominated in, or receive revenues in, foreign currency are subject to currency risk. Accordingly, the purchase of fund shares should be viewed as a long-term investment. Because the fund can invest a significant percentage of assets in debt securities that are rated below investment grade, the value of fund shares can be adversely affected by changes in economic conditions or other circumstances. These events could reduce or eliminate the capacity of issuers of these securities to make principal and interest payments. Lower-rated debt securities have speculative characteristics because of the credit risk of their issuers and may be subject to greater price volatility than higher-rated investments. In addition, the secondary market for these securities may lack liquidity which, in turn, may adversely affect the value of these securities and that of the fund. Accordingly, the purchase of fund shares should be viewed as a long-term investment. Mutual funds that invest in bonds can lose their value as interest rates rise, and an investor can lose principal.

Gross expense ratio 0.64% (Class I share) / 0.94% (Class R share). Net expense ratio 0.64% (Class I share) / 0.94% (Class R share). Waivers/reimbursements are contractual and are set to expire 1/31/12.

	Average Annual Total Returns as of 12/31/11					
	3 Months	1 Year	3 Years	5 Years	10 Years	Since Inception
Loomis Sayles Bond Fund (I shares)	2.51%	3.76%	17.37%	6.53%	10.00%	10.10%
Loomis Sayles Bond Fund (R shares)	2.52%	3.48%	17.06%	6.22%	9.71%	9.82%
Barclays Capital U.S. Government/Credit Bond Index ¹	1.18%	8.74%	6.60%	6.55%	5.85%	6.36%

Performance data quoted represents past performance and is no guarantee of future results. Total return and value will vary and you may have a gain or loss when shares are sold. Current performance may be lower or higher than quoted. For most recent month-end performance, visit loomissayles.com. Performance for other share classes will be greater or less than shown based on differences in fees and sales charges. You may not invest directly in an index. Performance for periods less than one year is cumulative, not annualized. Returns reflect changes in share price and reinvestment of dividends and capital gains, if any.

¹ The Barclays Capital U.S. Government/Credit Bond Index is an unmanaged index that includes U.S. Treasuries, government-related issues, and investment grade U.S. corporate securities. You may not invest directly in an index. Since inception performance is calculated from 05/16/1991 (I shares) and 12/31/1996 (R shares).

Morningstar Rankings as of 12/31/11 Intermediate-Term Bond Category	1 Year	3 Years	5 Years	10 Years
Loomis Sayles Bond (I shares) – Rank / # of funds	45% 112 / 250	16% 31 / 190	25% 38 / 151	8% 9 / 106
Loomis Sayles Bond (R shares) – Rank / # of funds	52% 130 / 250	18% 35 / 190	33% 50 / 151	12% 13 / 106

Past performance is no guarantee of future results. The fund's total return percentile rank for the specified time period is relative to all funds that have the same Morningstar category. The highest (or most favorable) percentile rank is 1, and the lowest (or least favorable) percentile rank is 100. Rankings are subject to change monthly, including the effects of sales charges, loads, and redemption fees.

Top 5 Holdings as of 12/31/11

Company	Percent of Assets
Canadian Government, 2.000%, 09/01/2012	3.00%
Norwegian Government, 6.500%, 05/15/2013	2.40%
Intel Corp., 3.250%, 08/01/2039	2.22%
Canadian Government, 3.500%, 06/01/2013	2.18%
Intel Corp.	2.03%

The top five holdings are presented to illustrate examples of the securities that the fund has bought and may not be representative of the fund's current or future investments. Performance of specific securities referenced is not guaranteed, nor are they representative of the entire portfolio.

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