

# Northern Small Cap Value NOSGX

**Morningstar's Take** | 12-16-09 | by Ryan Leggio

**Recent past will not be prologue here.**

**This year is no 2008 for Northern Small Cap Value.**

As 2009 comes to a close, this quantitative fund, which focuses on beating the Russell 2000 Value Index with less volatility, is having a lackluster year. While it is up 15% for the year to date through Dec. 14, that result trails its benchmark. In fact, this will be the first year since manager Robert Bergson took over in 2001 that the fund will likely finish in the bottom quartile of its small-value category.

Shareholders should not be concerned. The piece of its quantitative model that protected it so well in 2008—its loss was limited to 23% and landed it well in the category's best decile—was its "distress factor," which uses various metrics derived principally from a company's balance sheet to determine the likelihood it will face financial troubles in the near future. The model correctly predicted which companies would have the most trouble, especially in the financial sector, and Bergson thus avoided them. This factor, implemented in 2002, explains this year's performance too. Lower-quality companies, as judged by this measure, have simply been on a tear. For example, in the consumer discretionary sector, companies that receive a poor score are up 100% this year through the end of the third quarter, on average, while the companies the fund owns from the same sector are up around 30%.

While in hindsight lower-quality companies were probably cheaper on a relative basis at the start of the year, Bergson is unapologetic about this fund's bent toward quality. He has not made any major adjustments to the model either, preferring recent results over other possible outcomes. This is not the first time this has happened—in 2003, the fund also lagged other funds with lower-quality portfolios.

Overall, we remain confident in the fund. Bergson's consistent strategy has beaten the benchmark over every three-year rolling period since 2004. This year will prove to be just a blip on this fund's long-term record.

*Ryan Leggio is a fund analyst with Morningstar.*

## Kudos

- Disciplined approach.
- Reasonable expenses.
- Pure small-cap approach.
- Good long-term record.

## Risks

- Quantitative models won't always pick up on important qualitative factors, such as strength of management.
- Will lag when speculative fare is in the lead.

## Strategy

The fund's manager uses a quantitative model that selects small-cap stocks that trade cheaply relative to book value. His secondary screen considers price relative to earnings, cash flow, and sales. The fund holds tiny positions in hundreds of stocks. Its sector weightings are now loosely aligned with the Russell 2000 Value Index's.

## Management

Bob Bergson took over from Susan French in July 2001. He arrived at Northern in 1997 after serving as a director of investment research at a real estate consulting firm. Bergson is supported on the fund by a squad of quantitative analysts and researchers.

## Role in Portfolio

Supporting Player

## Northern Small Cap Value NOSGX

Year	Total Return (%)	+/- Category
YTD	1.55	—
2009	17.77	—
2008	-23.43	—
2007	-8.71	—
2006	20.28	—

Data through 12-31-09

# NORTHERN SMALL CAP VALUE FUND

Inception 4/1/1994

AVERAGE ANNUAL TOTAL RETURNS AS OF 6/30/10				TOTAL ANNUAL OPERATING EXPENSE RATIOS	
1-Year	5-Year	10-Year	Since Inception	Gross	Net
22.79%	0.56%	6.33%	8.49%	1.38%	1.00%

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**Equity Risk:** Equity securities (stocks) are more volatile and carry more risk than other forms of investments, including investments in high-grade fixed income securities. The net asset value per share of this Fund will fluctuate as the value of the securities in the portfolio changes.

**Small Cap Risk:** Small-capitalization funds typically carry additional risks since smaller companies generally have a higher risk of failure.

**Value Risk:** Value-based investments are subject to the risk that the broad market may not recognize their intrinsic value.

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