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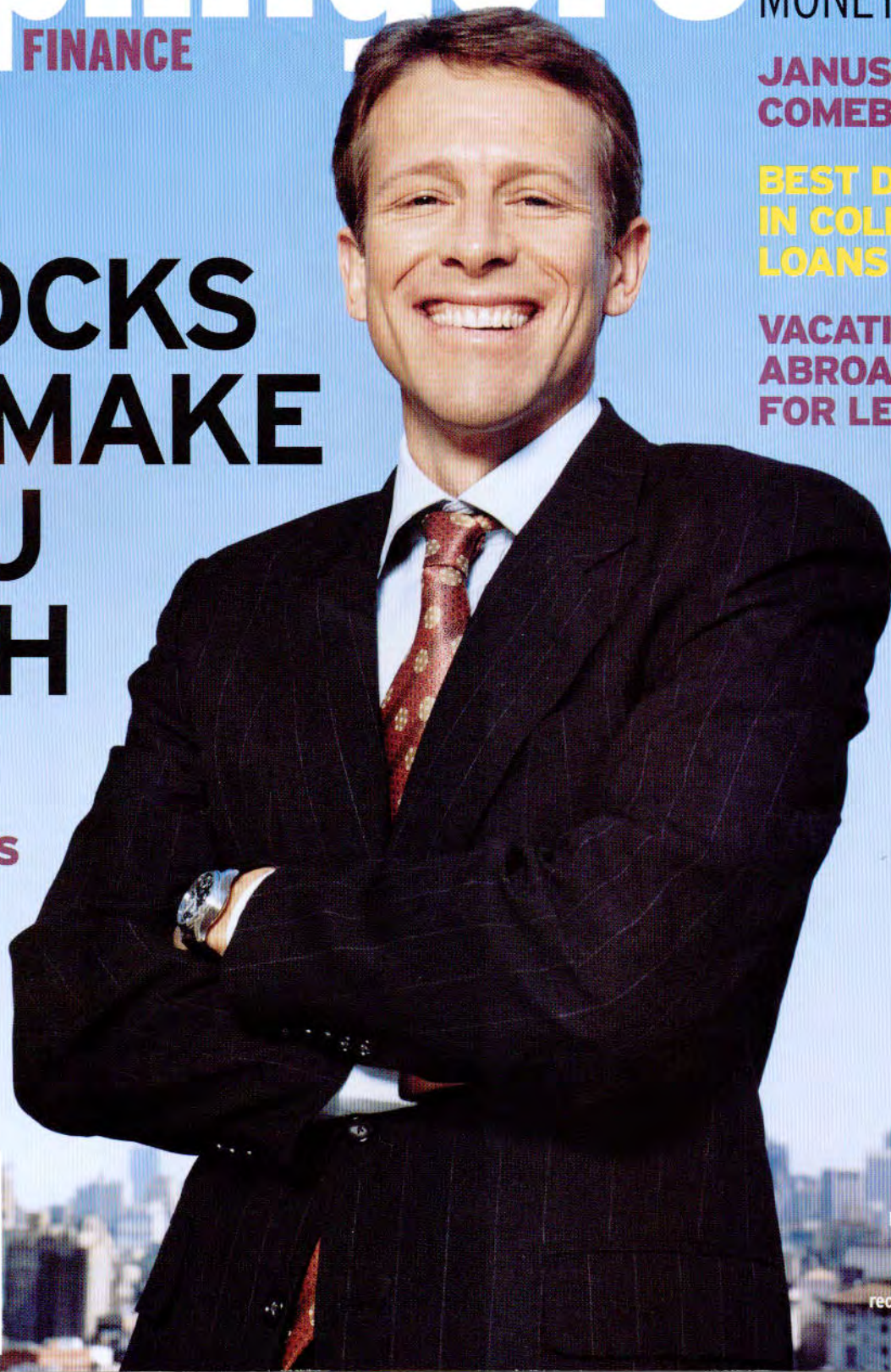
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Berkshire
Hathaway

McDonald's

Mueller Water
Products

21 stocks to make you RICH

COVER | Five-star money managers reveal their best investment ideas.

By *David Landis and Andrew Tanzer*

OF THE INFINITE number of possible stock-picking strategies, one that we particularly like can be summed up in three words: The pros know. In other words, ask the experts what stocks they're buying and you're likely to come up with some pretty good ideas. Last year, we asked seven top portfolio managers to name their favorites, and their 22 choices returned an average of 29% to May 14, well ahead of the 18% gain of Standard & Poor's 500-stock index (for more details, see the box on the next page).

Now we've rounded up a new group of outstanding managers using the same simple criteria we used to pick last year's bunch: They all have produced superior records, over both the short term and the long term. When these folks discuss their best investing ideas, it's worth listening in.

● Hedge-fund-turned-mutual-fund managers Whitney Tilson, left, and Glenn Tongue think McDonald's turnaround isn't over yet.

A BERKSHIRE BENT

MANY A MUTUAL FUND manager has bolted to the free-wheeling, less-regulated, potentially more lucrative hedge-fund world. Whitney Tilson and Glenn Tongue have done almost the reverse. They launched their first hedge fund in January 1999 (it returned an annualized 11%, after fees, to May 1, compared with an annualized gain of 4% for the S&P 500). Then in March 2005 they unveiled Tilson Focus, a concentrated mutual fund that invests in undervalued companies of all sizes. It returned 20% over the past year.

Tilson and Tongue look for safety, low price and rapidly growing value when they shop for stocks. If this reminds you of a certain investor in Omaha, it's for good reason. "We admit to being loyal Buffett disciples," says Tilson.

No surprise then that Warren Buffett's **Berkshire Hathaway** is Tilson Focus's largest holding. Tilson and Tongue see safety in Buffett's triple-A-rated holding company: "Its balance sheet

is Fort Knox-safe," says Tongue. The value of Berkshire's operating companies in particular, such as Geico, Gen Re and Shaw Industries, is compounding at a furious pace. Tilson says that pretax earnings of Berkshire's operating companies swelled by more than 30% a year from 1995 through 2006.

And Tilson and Tongue reckon that the shares are still cheap. When they apply a modest price multiple to the operating businesses and add the value of Berkshire's cash, bonds and big stakes in publicly traded companies, such as Coca-Cola, Moody's and American Express, they arrive at an intrinsic value of \$150,000 a share for Berkshire, a 36% premium to the stock price of \$110,000 (Berkshire Class B shares change hands for a mere \$3,668).

The story with **McDonald's** is different. This is a remarkable turnaround that Wall Street has consistently underestimated. The stock price has tripled since Tilson and Tongue first bought shares for their hedge fund in December 2002. A stream of successful new-product launches, such as McGriddles, salads and premium coffee, has produced more revenues (sales at stores open at least one year surged a tasty 8.2% in March) through a fixed asset base, resulting in rapidly expanding profit margins. Tilson thinks the stock, recently \$51, is worth at least \$60 a share.

Mueller Water Products is a more traditional deep-value pick. Spun off from Walter Industries late last year, Mueller is the leading maker and supplier of water-infrastructure products, such as fire hydrants, valves, couplings and transmission pipes. The stock, which sells at a small premium to book value (assets minus liabilities), has been depressed by the housing recession. But the water infrastructure in the U.S. is in urgent need of repair or replacement, so Tilson thinks it's just a matter of time before Mueller's flow of profits increases. He sees more than 50% upside in the stock, recently trading at \$16.

OVERSEAS AND OUT-OF-FAVOR

SINCE LAUNCHING Causeway International Value fund in 2001, Sarah Ketterer hasn't been afraid to go against the grain. She favors companies that are attractively priced because of temporary difficulties, and she will take large positions in a country or sector if the fund's strict stock-picking regimen determines that's where the values are. With a \$5-billion portfolio of large-company stocks, the fund seemingly has lots of room to grow. Yet Ketterer closed it to new investors to retain the flexibility to move back into midsize companies when prices in that segment moderate. Investors who got in before the doors were locked have been rewarded with a 17% annualized return over the past five years, which was achieved with relatively low volatility.

One of Ketterer's top picks, **Sanofi-Aventis**, illustrates how she achieves those low-risk returns. Shares of the Paris-based drug giant have fallen about 9% since July 2006 because of concerns about generic competition and delays in

UPDATE

Our team gains 29%

Last year we asked seven portfolio managers for their best ideas, and the 22 stocks they offered made up quite a portfolio. Seventeen of them posted double-digit gains, and all but three were in the black for the year. Overall, the picks returned 29% to May 14, including dividends, easily beating the 18% total return of Standard & Poor's 500-stock index.

The top-performing stock was Chaparral Steel, picked by Don and Craig Hodges, of the Hodges fund. It soared 129%. The Hodgeses' picks, including Texas Industries, which spun off Chaparral in 2005, gained an average of 47%.

Rudolph-Riad Younes, manager of Julius Baer International and Julius Baer International II (see "The 25 Best Mutual Funds," June), contributed three big gainers: Mexican homebuilder Homex Development, up 71%; French cement maker Lafarge, up 38%; and London-based distiller Diageo, up 28%. Overall, his picks returned 38%.

Hedge-fund manager Joel Greenblatt, of Gotham Capital, gave us two winning ideas: AutoZone, up 48%, and American Express, up 20%. Bruce Berkowitz, manager of the Fairholme fund, gave us three picks that produced an average return of 31%. Satellite-TV provider EchoStar Communications, which vaulted 59%, led the pack.

The picks of AI Frank fund's John Buckingham and CGM Focus's Ken Heebner returned 24% and 16%. One disastrous choice, clothier Christopher & Banks (down 34%), hurt Nancy Prial, of AMG Essex Small/Micro Cap Growth. Her picks gained just 3%, on average.