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TIP SHEET:

Blue-Chips Uncool But Manager Thinks They're Stars

By Shira Ovide

NEW YORK—These are the times that try money managers' souls. Double-digit market returns are harder to come by, and investors are looking to China or other unconventional investment targets to juice returns.

But not Jack Liebau.

Liebau, founder and president of Pasadena, Calif.-based Liebau Asset Management, believes investment basics still matter: Labor-intensive digging to find companies to buy and hold onto.

"I still believe in fundamental research and buying stocks for the long term," he says, "which I guess makes me almost old fashioned in this environment."

Liebau had a record of success as a portfolio manager at Primecap Management Co., and has had similar good returns with his four-year-old investment firm. The firm says a New York Stock Exchange-listed financial services company, its largest corporate client account at $85 million, posted a 9.3% gross return for last year. The comparable return for the Standard & Poor's 500 was 5.5%. Gross returns for the account's four-year lifespan are 52%, compared to 42% for the S&P 500. The firm declined to name the account.

The secret sauce is keeping it simple. Liebau invests in large, quality companies with good management, valuable assets and healthy balance sheets that can be bought at attractive prices.

Then he sticks with investments longer than most money managers. He says his portfolio turns over about 10% of its holdings every year, with a ten-year average holding time for securities. If his strategy means Liebau zigs when others zag, that's perfectly fine with him. "The worst thing to do is to follow the crowd," he says.

His investments in recent years include substantial positions in industrial firms and energy companies, including Exxon Mobil Corp. (XOM), 3M Co. (MMM), Deere & Co. (DE) and oilfield services company Schlumberger Ltd. (SLB). All outpaced the S&P 500 last year, with Deere nearly doubling in price during 2007.

Liebau believes sticking with blue-chips is sensible as high energy prices, sliding home values and other pressures on the U.S. consumer pinch economic growth.

"The larger companies generally have a higher percentage of operations abroad, and especially with the drastic decline in the U.S. dollar their foreign operations should drive good profit growth relative to smaller cap companies, which tend to be domestic only," he says. "It's finally time for the large growth stocks to have their time to shine."

Liebau pegs the odds of a U.S. recession at about 50-50, but isn't afraid to invest in companies with large exposure to economically-sensitive sectors. One of his favorite holdings is science-based products and services company E.I. DuPont de Nemours & Co. (DD), widely perceived as a company that could take a hit from an economic downturn. Liebau, however, likes DuPont's strong and growing seed and agriculture division.

Wal-Mart Stores Inc. (WMT) is another company expected to suffer as consumers with moderate incomes take a hit from higher costs for gasoline and other economic pressures. Liebau says he looks beyond the potential problems to Wal-Mart's successes in bringing inventory and costs back in line after missteps in fashion.

Liebau also says the retailer's management team has weathered criticism from labor and political-interest groups. Liebau says the company's stock is trading at a low valuation of about 13 times earnings, compared to a valuation ratio eight years ago of above 40.

His predilection for blue-chip firms isn't fashionable, which he says irks some of his clients. "A lot of the individual clients I have read about some hot new sector—Chinese stocks or dot-coms or solar energy—and want to hop on board what stocks are doing best at the time," he said. "You might as well go to Hollywood Park or Belmont racetrack."

Liebau is well versed in the whims of the track. He owns and races thoroughbred horses, although he concedes he's far less successful as a racehorse owner than as a money manager.

Horse racing is just one of several unconventional bullet points in Liebau's resume. He did a stint in the newsroom of the Los Angeles Times newspaper and owned a farm in the central valley of California.

Though seemingly unconnected to his money-manager career, he says his gigs built useful skills in his day job. Liebau credits his newspaper background for teaching him to dig for information and making him appropriately skeptical of what people tell him.

The farm, he says, helped cement the notion that "You don't know where a good idea will potentially come from." He said reading agriculture magazines taught him about seeds and genetic technology, which led to investment in Monsanto Co. (MON), plant-genetics firm Pioneer Hi-Bred International Inc. and seed firm DeKalb Genetics Corp. The latter two were taken over at healthy premiums.

Liebau has shunned exposure to mortgages and other troubled credit securities for which investors have been punishing banks and other financial firms. Still, Liebau—not by nature a bottom feeder—believes there remain opportunities in the financial sector. "The market has been totally indiscriminate about marking down the high quality financials along with the ones that should be sold," Liebau says. He cites Wells Fargo & Co. (WFC) as one such unfairly burned firm.

Liebau plans to carefully add well-managed financial companies to his portfolio as long as stocks are battered by worries about exposure to and other troubled credit securities. Liebau also says it imperative to tread carefully. "I suspect we're in for more disappointing news for financial stocks," he says.

The credit crunch and massive bank write downs validate his research- and labor-intensive approach, Liebau says. "I think it highlights the importance of doing fundamental research and knowing the company and managements and having a history with managements and having a sense of ethos of the company and the credibility of management," he says.