

BILL MILLER, MERE MORTAL

**AFTER BEATING
THE S&P 500 FOR
15 YEARS RUNNING,
LEGG MASON'S STAR
MONEY MANAGER IS
TRYING TO SHAKE OFF
THE WORST SLUMP
OF HIS CAREER.**

By Danielle Kost

◀ The bad news streamed down via satellite to a private yacht cruising somewhere off the Leeward Islands.

On board, Legg Mason Inc. money manager Bill Miller was bracing for the blow: The market, he knew, had beaten him at last. His streak—15 years of besting the Standard & Poor's 500 Index—had come to an end. The final numbers showed he'd returned 5.9 percent in 2006, trailing a 15.8 percent gain by the S&P 500.

There was little cheer at Baltimore-based Legg Mason when Miller returned from his late-December sail. Miller says there was no buck-up message waiting for him from his boss, Raymond "Chip" Mason. Nor were there condolences from his friend Warren Buffett.

Miller, the mastermind behind the \$21 billion Legg Mason Value Trust mutual fund, says people often ask if he's somehow relieved that his run, one of the greatest in the history of investing, is finally over. "The answer is: No," Miller, 57, told Value Trust shareholders in a January letter discussing his 2006 performance. "We are paid to do a job, and we didn't do it this year—which is what the end of the streak means—and I am not at all happy or relieved about that."

Miller has stumbled at a critical time for his firm. Legg Mason, which manages \$945 billion, has been trying to meld itself with the fund management arm of Citigroup Inc.

Unbowed: Legg Mason's **Bill Miller** says he has no plans to change tack because of one bad year.



Legg Mason swapped its brokerage arm for Citigroup's money management division in 2005, doubling its assets. Miller's Value Trust has fallen further behind the S&P 500 in 2007, with a 1.6 percent loss through March 7, compared with a 1.27 percent decline for the index.

"It's happened at a very key moment, just when sales of that fund could have really exploded," says James Schmidt, who oversees \$4 billion for rival money manager John Hancock Funds Advisers in Boston.

Colleagues say Miller has been feeling the strain. After Value Trust fell behind the S&P 500 during the first quarter of 2006, David Nelson, senior vice president of Legg Mason Funds Management Inc., shot Miller an e-mail saying "Hang in there."

"The pressure on Bill is enormous," Nelson says.

Ryan Caldwell, an analyst at Overland Park, Kansas-based Waddell & Reed Financial Corp., says most investors have written off Miller's 2006 performance. A second year of poor returns would hurt the Legg Mason money manager, he says. "There will be some cache issues," he says.

It hardly helps that Legg Mason shareholders have taken a roller coaster ride of late. On Oct. 11, the stock took its biggest dive ever, tumbling 17 percent in a day, after Legg Mason said quarterly earnings would fall short of analyst estimates. The shares ended 2006 down 20 percent for the year. The stock has bounced back in 2007, gaining 4.66 percent through March 7, after a late-2006 rally in world stock markets boosted mutual fund fees at the company. By mid-March, the markets had sputtered.

Sitting in his 22nd-floor office overlooking Baltimore Inner Harbor, Miller refuses to mope over his mistakes. He's made his name by buying stocks that other people shun and holding them for years. His picks of Dec. 31 included Arlington, Virginia-based power producer AES Corp.; Reston, Virginia-based mobile phone company Sprint Nextel Corp.; and Bermuda-based conglomerate Tyco In-

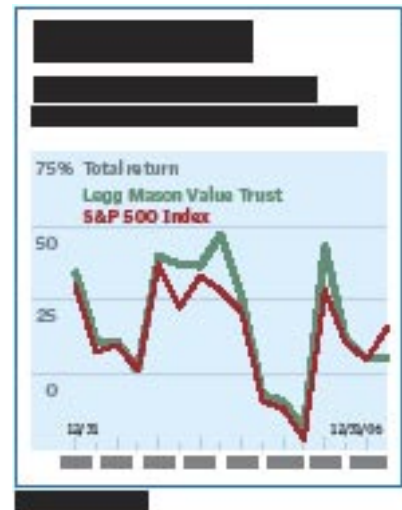
ternational Ltd. Miller looks for investment ideas just about everywhere. His office bookcase covers an entire wall and holds works ranging from the Koran to *Moneyball: The Art of Winning an Unfair Game* (W. W. Norton & Co., 288 pages, \$24) by Bloomberg News columnist Michael Lewis. More books are stacked atop Miller's desk, and he has thousands of volumes at home.

Miller says he has no plans to change tack just because he's had one bad year. He realized as early as July 2006 that his streak was in jeopardy. All year, nervous clients kept calling. "I got asked, 'How do you go about analyzing your mistakes?'" Miller says. "I said, 'I don't. I don't analyze my mistakes.' We will analyze spectacular errors, but not garden variety errors."

Miller has picked some doozies in his day. In the center of his bookcase sit framed stock certificates of past bloopers, including Enron Corp. and WorldCom Inc. Value Trust pick Sprint Nextel fell 10.4 percent in 2006. UnitedHealth Group Inc., another of his favorites, lost 13.5 percent. A third choice, Amazon.com Inc., sank 16.3 percent last year. Miller's bets on homebuilders soured in 2006, too.

His recent showing was a rare misstep for Miller, who posted an average annual return of 16.2 percent from 1990, when he became sole manager of Value Trust, to 2005. His record puts him in the same league as his friend Buffett, whose Berkshire Hathaway Inc. delivered an average annual return to shareholders of 18.8 percent from 1991 to 2005. Buffett, unlike Miller, beat the S&P 500 in 2006, with a 24.2 percent return. "It still would be hard not to see Miller as one of the best investment managers of his generation," says Christine Benz, director of fund analysis at Chicago-based Morningstar Inc. "Many of the best managers run into periods of weakness."

Such assurances don't change the fact that Miller is mired in the worst slump of his career. He's the first to say his streak was partly luck anyway. For starters, his run reflects a fluke of the calendar: If Pope Gregory XIII hadn't



tweaked the Julian calendar in 1582 to shorten the average number of days in a year, Miller wouldn't have beaten the S&P 500 for 15 years. Sometimes, he scraped by in the final days of December. In 2005, for example, he beat the index by a mere 0.4 percentage point. Two weeks later, Value Trust's return sank below that of the S&P 500.

In his January letter to investors, Miller said that if beating the market were purely random, like tossing a coin, then the odds of beating the S&P 500 for 15 consecutive years would be the same as the odds of tossing heads 15 times in a row. Using the actual probabilities of beating the market in each of the years from 1991 to 2005, he put his odds at 1 in 2.3 million. "So there was probably some skill involved," Miller said. "On the other hand, something with odds of 1 in 2.3 million happens to about 130 people per day in the U.S., so you never know."

Miller, a disciple of value investor Benjamin Graham, tends to go against the crowd, sometimes literally. A few years ago, he shifted his work hours to avoid rush-hour traffic. "I took to reading the newspapers while I was sitting in traffic, which probably wasn't the safest thing," he says.

Miller usually rises before 7 a.m. at his home in suburban Ruxton, Maryland, reads four newspapers, checks the markets and then makes the 11-mile (18-kilometer) drive to his Baltimore office after noon. His day ends around 8 p.m. He says he hates waiting in lines at movie theaters and restaurants too.

At 6 p.m. on a September Wednesday

day, members of Miller's staff are lined up waiting to see him inside the headquarters of Legg Mason. A Navy admiral would feel at home in this place. The rooms are painted pastel blue and yellow and trimmed in white. Paintings of ships on both turbulent and tranquil seas adorn the walls. By this time last fall, Miller says, he already knew his streak was ending. You'd never know that this button-down guy with thinning gray hair was on edge. "Bill has ice water in his veins," Mason, 70, says. "It's probably his greatest asset."

Miller has been following the markets since his boyhood. Born in Laurinburg, North Carolina, he grew up in Jacksonville, Florida, and later, Miami. He says he became interested in the stock market after seeing his father, who ran a trucking company, look up stock prices in the newspaper.

After collecting a bachelor's degree in economics from Washington & Lee University in Lexington, Virginia, where he pitched on the school's baseball team, Miller went to work as a U.S. Army intelligence officer in Germany. While working overseas, he met his future wife, Leslie Williamson.

When the couple returned to the U.S., Williamson took a job in the research department of Legg Mason. Miller began working on a doctorate in philosophy at Johns Hopkins University. He decided against writing his dissertation while struggling to pay his school bills and took a job as treasurer of J.E. Baker Co., a now defunct York, Pennsylvania-based maker of materials for the cement and steel industries. Miller used to pick up Williamson after work at Legg Mason, often arriving early so he could read research reports. Mason noticed him and suggested he talk to Ernie Kiehne, then director of research, about a job. "I liked his smile, and he pitched right-handed, just like me," Kiehne, 88, says. Kiehne hired him. Miller was 31.

"He was about as green as they get," Mason recalls.

When Legg Mason opened Value Trust in 1982, with Mason as its first investor, Kiehne and Miller set out to look

for stocks trading at low prices relative to expected earnings and book values, or assets minus liabilities. The pair's first purchases included Westinghouse Electric Co. and Ball Corp., a maker of beer and soft drink cans. "It was going to be our proxy to show we did know how to help people make money," Mason says. "It turned out better than I ever dreamed."

By 1984, Value Trust had amassed \$200 million. When Kiehne retired in 1990, Miller became Value Trust's sole manager. The next year, Miller beat the S&P 500 by 4.3 percentage points. The streak was on.

Legg Mason Capital Management, which oversees \$67.9 billion, grew out of Value Trust. Miller's flagship fund and others mimicking its strategy account for \$49 billion of assets under management. The rest is spread across the division's other funds, including the \$7.2 billion Legg Mason Opportunity Trust, which Miller also manages. Legg Mason Capital Management, of which Miller is chairman, has more than quadrupled its staff to 132 people since 2000.

"Bill Miller has always been Legg Mason," says Tom Hirschmann, the company's head of institutional sales. As Miller's fame grew, so did his influence over the companies in which he invests. In February 2006, for example, Miller urged Tyco International to buy back stock. That May, Tyco authorized a \$2 billion repurchase.

Lately, Miller has been drawing from the field of behavioral finance, which melds psychology and economics, as well as from work done at the Santa Fe Institute, a think tank in New Mexico that focuses on physical, biological, computer and social sciences. The institute, founded in 1984, does so-called complex systems research. It tries to uncover links among artificial, human and natural systems. "The frontier of science is something that excites the living daylights out of him," says Miller's friend Paul McCulley, managing director at Pacific Investment Management Co., of the Legg Mason manager.

Miller became interested in the Santa Fe Institute while reading about its work after the 1987 market crash. In 1992, Legg Mason became one of the first companies to join the think tank's business network. Miller is now chairman of the nonprofit institute and travels to Santa Fe four times a year.

While visiting the Santa Fe Institute in 2004, Miller came up with a plan to invest in Google Inc., which sold stock to the public that year via auction. "Bill turns to me and says, 'Let's do an impromptu discussion,'" says Michael Mauboussin, Miller's chief investment strategist and a Santa Fe Institute trustee.

Miller later corralled former eBay Inc. Chief Financial Officer Gary Bengier, technology entrepreneur James Rutt and mathematician David Weinberger to chat about Google. Miller put Legg Mason co-head of research Randy Befumo to work analyzing the odds that a couple of computer whizzes in a garage somewhere might come up with a Google rival.

Miller concluded that Google, a stock many traditional value investors refused to touch, looked like a buy. He was right. The stock soared to \$455.55 on March 7 from an initial price of \$85 in 2004.

Miller has occasionally drawn fire for buying stocks such as Google and stretching the definition of value investing. Morningstar Inc. classifies Value Trust as a "large blend" fund rather than a value fund.

And Miller puts all his eggs in a few baskets. He typically holds no more than 50 stocks at a time. He takes big positions and holds them for five years or more. While other Legg Mason Capital Management fund managers have free rein over their investments, they follow Miller's overall strategy and hold some of the same stocks.

Miller's fans admire his nerve. "When you produce long-term results like that, you have to be an independent thinker," says Vaughn Antley, a senior investment officer at Argent Financial Group in Monroe, Louisiana, which has invested in Value Trust for a decade.

Miller hasn't changed his schedule or lifestyle because of the hiccup at Value Trust. Even so, Mason says his star money manager attended conferences in 2006 that he might have passed up before his returns faltered. "He just needs to air out a little bit and think about things, put things in perspective," Mason says.

Miller has the money to walk away. While Legg Mason doesn't disclose his salary, Miller clearly enjoys the trap-

pings of success. He has a vacation home in Maine, an apartment in New York and, in his words, "a pretty-good-size position" in Legg Mason stock.

Miller is stubborn and doesn't concede defeat easily, Mason says. Miller himself says he has a high threshold for loss, comparing himself to a "brain-damaged" person who doesn't recognize the emotional pain of a losing bet.

Miller often sticks to his guns, even when doing so costs his investors money in the short term. In late 2003, for example, he met with Michael Goldstein, an analyst at Empirical Re-

search Partners LLC, to talk about buying energy stocks. Oil had yet to rally beyond \$35 a barrel. Miller decided against wading in because oil stocks had already begun to rise. As a result, Value Trust missed the 2004-05 rally in energy stocks as crude prices soared.

"Bill tends to catch falling knives, and every now and then, you're going to cut your hand," Mason says. "Hopefully, you catch the handle at the end, but you're liable to slice your fingers off." ▶

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PERFORMANCE, LAST 12 MONTHS*



BLOOMBERG TOOLS

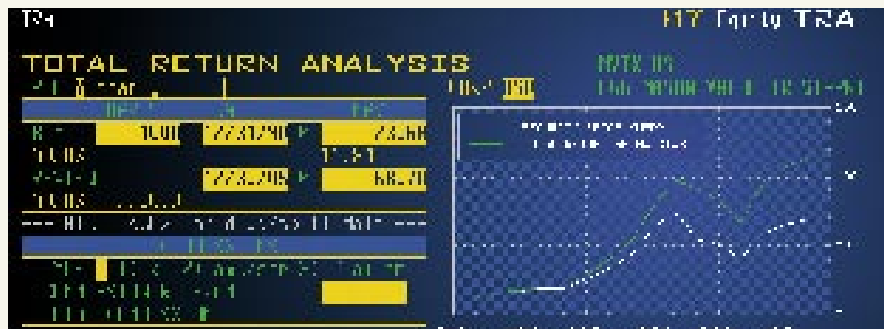
Bill Miller's Funds

You can use the new People Search (PEOP) function to find information on the funds that Legg Mason's Bill Miller manages. Type PEOP <Go>, tab in to the GIVEN NAME field and enter *BILL*. In the FAMILY NAME field, enter *MILLER*. Next, tab in to the ORGANIZATION field, enter *LEGG MASON* and type <Go> 1 <Go>. In the search results, click on Bill Miller to see his Bloomberg profile.

Type 18 <Go> for a list of funds managed by Miller. To find information on the returns of the Legg Mason Value Trust, first click on its name. Next, type TRA <Go> to use the Total Return Analysis function to calculate the fund's returns for a selected period. For the 15-year performance of the fund, tab in to the PER field and enter *Y*. Next, tab in to the first DATE field, and enter *12/31/90*. Enter *12/30/05* in the second DATE field, and press <Go>.

The fund's annual return including reinvesting dividends was 16.2 percent. To compare the return of the Standard & Poor's 500 Index during the same period, type SPX <Index> TRA <Go>. Repeat the steps, entering the dates for the 15-year period, and press <Go>. The S&P 500 returned 11.4 percent a year during that period. The Legg Mason Value Trust thus outperformed the index by 4.8 percentage points on average for 15 years.

CHRISTOPHER RUNG



For a relative return graph for the Legg Mason Value Trust, type LMVTX US <Equity> RG <Go>.