IMPATIENT RETURNS

What do you get when you mash up deep value with hedge-fund style trading? Meet Gabelli's hot-handed young fund manager Dan Miller.

BY STEVE SCHAEFER

Gabelli Focus Five Fund portfolio manager Dan Miller (Credit: Ian Londin for Forbes)

Diversification is protection against ignorance. It makes little sense for those who know what they're doing." These words, once uttered by Warren Buffett, are blasphemy to anyone following modern portfolio theory–the widespread practice dictating that investors own a diversified portfolio of stocks. For most financial advisors Buffett's statement is downright insulting

But for Daniel Miller, the brash and boyish 32-year-old portfolio manager of the Gabelli Focus Five fund, Buffett's words are the gospel of superior performance. His budding mutual fund is what value investors refer to as a deep value concentrated portfolio. According to its charter, Miller is allowed to invest up to 50% of its assets in his five best ideas.

So far Miller's approach to stock picking has produced big results. Since he started managing the fund 16 months ago it has gained 46.5%, compared with a total return of 36.2% for the S&P 500. Assets have swelled from $5 million to $230 million in a little over a year.

Miller's success is no flash in the pan, either. The idea for the Focus Five mutual fund came out of a research report he published at Gabelli & Co. as head of institutional equities starting in January 2006. Each quarter the Focus Five research report gathered best-idea stock recommendations developed by the firm's research team and selected five stocks trading at least 30% below their private-market or takeover value. As a rule, every one of the five was required to have a near-term catalyst that would drive its price higher, and no stock could remain in the portfolio for more than six months.

Here, for example, is a Focus Five pick of January 2008: Take-Two Interactive Software, which makes the Grand Theft Auto series of videogames. In the three-month period Gabelli recommended the stock, Take-Two gained 84% thanks to a takeover bid from Electronic Arts. The bid was ultimately dropped, but by then Miller's research service had removed it from its list.

Picks like that made Gabelli's Focus Five report popular among clients. Over six years through the end of 2011 these stocks trounced the broader market, returning 224.6%, compared with a 0.1% decline for the S&P 500. The Focus Five mutual fund, launched in January 2012, mimics its high-octane strategy.

[Staking Dan] was not like bringing somebody in from the sell side and saying, 'Now that you're running money, we'll see,'" says Mario Gabelli.

One big difference between this no-load mutual fund and the research report is that Miller insists on direct access to top management, with whom he talks regularly. He can also hold stocks longer and looks for a catalyst within 18 months.

Focus Five, however, is run more like a hedge fund than anything out of the Buffett school of value investing. Miller's 29-stock portfolio has an expense ratio of 1.7% and a turnover rate of 39%, versus 16% or less for other concentrated funds like Sequoia Fund and Third Avenue Value fund.

On a sun-splashed May afternoon he pulls up to the Rye, N.Y. train station to take a reporter on a short ride to the Gabelli office, a two-story building off I-95.

About two years ago his sister was trying to get funding for a movie she had co-written, For a Good Time, Call. But when the initial financing fell through, brother Dan stepped in to help. "I knew nothing about the movie business, but I know how to raise money," he says. After some calls to friends and colleagues, he was able to raise $1.2 million, and the movie was filmed in 17 days.

At the Sundance Film Festival in January 2012 it wound up being the second-biggest sale of the festival, reaping $2.5 million from distributor Focus Features, a subsidiary of NBC Universal. Despite its ultimate failure at the box office, executives at Gabelli profited handsomely, as did money manager friends like Bill Priest, the chief executive of $27 billion (assets) Epoch Investment Partners. "I think Dan has a nose for money," says Priest. "You don't get that from school."

In fact, Miller makes up for his lack of Ivy League pedigree with an abundance of ambition. Born on Long Island but raised in Lakeland, Fla., he is the son of a plant manager and a schoolteacher. He started investing at 13 after he attended a stock market camp at the Breakers Hotel in Palm Beach.

In high school he was a member of the Future Business Leaders of America club. After getting a tour of the University of Miami's undergraduate business school from its dean, he applied for early decision, got in with an ample scholarship and majored in finance. Miller interned at Lehman Brothers for two summers and, during his senior year, became student representative to the university's board of trustees. This got him invited to a meeting with several of the investors managing the university's endowment, including Mario Gabelli.

The meeting helped Miller land a job in Gabelli's operations department after he graduated, and eventually he was asked to revive the firm's institutional equity sales operation. By the end of 2005, just three years on the job, he was leading the firm's morning research meetings, where ideas were discussed.

A CATALYST IN EVERY STOCK

GABELLI'S FOCUS FIVE FUND IS MAKING BIG BETS ON THESE STOCKS.

STOCK/ TICKER	MARKET VALUE ($BIL)	EV/ EBITDA	RECENT PRICE	PRIVATE MARKET VALUE
COINSTAR / CSTR	$1.6	4.0	$56	$75
GENERAL MOTORS / GM	46.8	1.3	34	43
GNC HOLDINGS / GNC	4.4	9.3	45	60
KENNAMETAL / KMT	3.4	6.1	43	60
WEATHERFORD INT'L / WFT	10.7	6.9	14	20

PRICES AS OF MAY 29 SOURCES: GABELLI & COMPANY; THOMSON REUTERS FUNDAMENTALS AND INTERACTIVE DATA VIA FACTSET RESEARCH SYSTEMS.

Talking to Miller you get the feeling that he'd much rather be running a hedge fund than a staid mutual fund. "I feel like we earned our fee in the fourth quarter last year," he says, citing his 8.4% return versus a flat S&P.

Today Miller's top five stocks include coin-counting and DVD kiosk company Coinstar, industrial tool maker Kennametal, vitamin seller GNC Holdings GNC, oilfield services firm Weatherford International WFT and General Motors GM. While Miller's go-anywhere style tends to translate into holdings with market caps in the $3 billion to $10 billion range, these five, which make up 31% of his portfolio, have market caps ranging from $1.6 billion to $47 billion.

Coinstar, in Bellevue, Wash., sells for just four times its cash flow, but according to Miller it is chock-full of catalysts that could send its stock higher in a hurry. The company is changing its name to Outerwall to reflect its move beyond coin-counting machines. Its popular Redbox business of DVD kiosks is taking aim at Netflix NFLX -2.61%, teaming with Verizon to offer a streaming movie service at $8 per month, with a credit for four DVD rentals. Gourmet coffee kiosks, under the Rubi brand, are another new vending machine rollout. What Miller especially likes is that almost half of the stock's float is being shorted, and there are rumors of a possible private equity bid. Miller says Coinstar's low valuation is driven by an underestimation of Redbox's potential. "DVDs aren't going to die tomorrow," he says. One key to Miller's high returns–and an important attribute for successful investing–is his mercenary view of the stocks in his portfolio. He says, "I've sat in meetings with management where I left and sold our position the next day."

Rochester Medical, maker of urinary-tract catheters, is a good example. When Miller asked senior managers why they weren't buying back their stock, they skirted the question but minutes later indicated they favored investing in new technology instead. Miller was out of the stock within a week.

Miller flashes his unadorned ring finger and says, "I don't fall in love."

IMPORTANT INFORMATION

Returns represent past performance and do not guarantee future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so, upon redemption, shares may be worth more or less than their original cost. To obtain the most recent month-end performance information and a prospectus, please call 800-GABELLI or visit www.gabelli.com. Effective January 1, 2012, the Fund changed its name and investment strategy from "The Gabelli Woodland Small Cap Value Fund" to "The Gabelli Focus Five Fund". Through March 31, 2013, 27.10%, 9.23%, 10.52% and 9.36% are the one year, the five year, the ten year, and life of Fund (12/31/02) average annual returns for The Gabelli Focus Five Fund Class AAA shares (GWSVX). The current expense ratio after reimbursement from Advisor for The Gabelli Focus Five Fund Class AAA shares is 1.71%. The gross expense ratio is 2.41%. The Advisor reimbursed certain expenses to limit the expense ratio during the period from inception. Had such a limitation not been in place, returns would have been lower. The Fund imposes a 2% redemption fee on shares sold or exchanged in seven days or less after the date of purchase. The S&P 500 Index is an unmanaged indicator of stock market performance and is adjusted for reinvestment of dividends. You cannot invest directly in an index.

Total returns and average annual returns are historical and reflect changes in share price, reinvested dividends and capital gains and are net of expenses. Stocks are subject to market, economic and business risks that cause their prices to fluctuate. Consequently, you can lose money by investing in the Fund. Performance pertains to Class AAA shares only. Other share classes may have different performance characteristics. Past performance of Gabelli & Company, Inc.'s research report, The Focus Five (published quarterly from January 2006 through November 2011), is not affiliated with The Gabelli Focus Five Fund. The investment strategy of the Fund is different than the stock selection process of the research report.

Dan Miller is a member of the portfolio management team for The Gabelli Focus Five Fund. Individual securities mentioned are not representative of the entire portfolio. The views expressed in this article reflect those of the Portfolio Manager only through June 5, 2013. The Portfolio Manager's views are subject to change at any time based on market and other conditions. As of March 31, 2013, The Gabelli Focus Five Fund held the following as a percentage of its net asset value: Coinstar 7.1%; GNC Holdings 5.8%; Weatherford International 5.3%; General Motors 5.0%; Kennametal 3.5%. The Fund did not hold positions as of March 31, 2013 in other companies mentioned. Other funds mentioned are distributed by other distributors and may have investment objectives, risks, expenses, and charges that are different than The Gabelli Focus Five Fund.

The Fund is classified as a "non-diversified" mutual fund, which means that a greater proportion of its assets may be invested in the securities of a single issuer than a "diversified" mutual fund. As a non-diversified mutual fund, more of the Fund's assets may be focused in the common stocks of a small number of issuers, which may make the value of the Fund's shares more sensitive to changes in the market value of a single issuer or industry than shares of a diversified mutual fund.

Investors should consider the investment objectives, risks, sales charges and expense of the fund carefully before investing. The prospectus contains more information on this and other matters. Please read the prospectus carefully before investing.

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