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A Fund Shines by Investing in Rust Belt

By UDAYAN GUPTA
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—Debra Diamond is pulling ahead of the other growth-stock fund managers by investing in the dull and the dreary.

Let the other stock pickers try to snare another IBM by snapping up high-technology clones and biotech look-alikes. At **T. Rowe Price Associates** Inc. in Baltimore, Ms. Diamond is putting the clients' money into small companies in the Rust Belt.

She's banking on a pickup in capital spending to boost her portfolio, which includes **Spartan Motors** Inc., a 13-year-old maker of chassis for special vehicles such as ambulances and fire engines; **L.B. Foster** Co., a producer of construction pipes and pile drivers, and **International Shipholding** Corp., which moves freight between the U.S. and foreign ports.

Debra Diamond

Not that fund shareholders are complaining. The portfolio she manages in Baltimore, T. Rowe Price's $36 million **New Frontier Fund**, has surged 37.5% this year through last Thursday, beating the S&P 500 index's 17.9% rise and the Nasdaq composite index's 14.2% gain. While small-company growth funds were down 2.5% on the basis of total return in the third quarter, her fund gained 1.5%.

The 36-year-old money manager began her career as an analyst at T. Rowe Price's **New Horizons Fund**, which manages almost $900 million of small-company stocks. In 1985, when the firm wanted to develop another small-company growth fund for European investors, she got the nod to manage New Frontier. The fund is still aimed mainly at European investors.

Simple Strategy

Ms. Diamond's strategy is disarmingly simple. Not a strong believer in market timing or frenzied buying and selling, she looks for companies that don't have large institutional followings—usually those valued by the stock market at less than $50 million. "You outperform others by buying in early into companies with strong financial characteristics—strong balance sheets, little debt and a high return on equity," she says.

The strategy worked well until last October's crash. Then, before you could blink, New Frontier's assets plummeted 40%, to $22 million from a pre-crash $37 million. "All small companies got hit by the crash, but our companies—smaller than most—were hit even harder," Ms. Diamond says. "Sometimes we were reduced to one market maker, and they didn't want our business."

Yet since it was formed in June 1985, the fund s return has totaled 80.9%, well above the 61% increase in the S&P 500 and the 28.4% gain in the Nasdaq composite index.

Very few of Ms. Diamond's picks appear on other fund managers' lists. And she's often tracking out-of-favor companies introducing new products or repositioning old ones. What she doesn't believe in is promises: She avoids one-product companies and those with a skimpy track record.

Contrast in Philosophy

Her philosophy contrasts with those of some of this year's hottest small-company funds. **Kaufmann Fund**, for example—this year's top fund performer with a gain of 63% through last Thursday—invests largely in small, speculative issues with little earnings history.

She learned to avoid such stocks the hard way. For instance, Ms. Diamond bought **Microwave Labs** Inc. at its initial offering price of $6 a share, convinced that the company would be a leader in providing microwave parts to the military. But the company hasn't performed and "every quarter they have a different excuse," Ms. Diamond complains. Microwave currently is selling at 2½.

A year ago, she began buying International Shipholding, a stodgy old freight carrier, because the shipping business was improving. International Shipholding stock, which she purchased at 10, now is at 18¼.

In August, she began buying **Gaming & Technology** Inc., a somewhat forgotten provider of slot machines, because other companies in the same market were thriving. Gaming & Technology now is trading at $8.75, up from the $7 a share she paid for it.

Ms. Diamond shies away from most high-technology stocks. "The industry's real growth is behind it," she asserts. She also believes that the companies sell on promises, which often aren't fulfilled.

Less than 35% of Ms. Diamond's holdings change in a given year, she notes, far less than most other funds. And her portfolio's price-to-earnings ratio is 11—less than the Nasdaq's P-E ratio of 12 and below New Horizon's 14.

Though many fund managers seem to be avoiding small-company stocks, Ms. Diamond is carrying on undaunted. Her picks continue to be focused on some of the more mundane companies in niche markets: **Programming & Systems** Inc., which operates trade and technical schools; **Video Display** Corp., which rebuilds cathode ray tubes and sells them; and **American Student Lists**, a seller of lists of high school and college students.