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Special Report

TOP-PERFORMING MANAGERS

Value big over the year, but growth trumped in five year race

By ROB KOZLOWSKI

Small-cap strategies thrived in 2021, taking up the top five spots in the domestic equity rankings for the year ended Dec. 31, according to the latest data from Morningstar Inc.'s separate account/collective investment trust database.

Of those top five strategies, three were categorized as value strategies by Morningstar, one was growth and one was blend.

A financial-sector strategy and four equity energy strategies managed by Miller/Howard Investments rounded out the top 10.

The overall median return for domestic equities within the Morningstar separate account universe was 25.03% for the year ended Dec. 31, compared with the Russell 3000 index return of 25.6%.

Stephen Welch, Chicago-based analyst with Morningstar Inc., said in a phone interview that for the year, small-cap and microcap strategies led the way, although those market caps did cool off during the fourth quarter.

Within small caps, value strategies dominated, Mr. Welch said. For the year ended Dec. 31, the Russell 2000 Value index returned 28.2%, while the Russell 2000 Growth index returned 2.8%.

"That's why you're seeing the three small value SMAs rise to the top there," Mr. Welch said. "Up cap it was more of a different story. It was a definitely a closer range, (although) large-cap growth performed slightly better than value."

In Morningstar's universe, the median return for overall value strategies for the year ended Dec. 31 was 27.96%, while growth strategies returned a median 20.8%.

Leading the rankings for the year ended Dec. 31 was Houston-based Bridgeway Capital Management LLC's small-cap value strategy, which returned a gross 69.19% for the period.

Elena Khoziaeva, head of U.S. equity and portfolio manager, said in a phone interview that the firm "believes in numbers and statistics, and we believe in developing systematic disciplined processes of analyzing a company's data and creating an investment portfolio."

The firm studies and attributes performance to a diversified factor model that is grouped into three categories: company financial health, price momentum and value metrics. Those categories are kept distinct in the portfolio in order to capture the benefits of diversification.

"Stocks are selected by various models, and as a group, they provide deep exposure to particular factors," Ms. Khoziaeva said. She noted that the strategy benefited greatly from having those categories unique and separate because there was always one or two categories that experienced excellent returns on a quarterly basis throughout the year.

Antero Resource Corp., an oil and gas company, and **United Natural Foods Inc.**, a distributor of natural foods and related products, are examples of holdings within the value metrics model that helped drive outperformance, Ms. Khoziaeva said.

Ranked second was St. Louis-based Kennedy Capital Management Inc.'s microcap opportunities strategy, which returned a gross 68.9% for the year ended Dec. 31.

IN-HOUSE: Robert Scott cited research as the main reason for Next Century's strong five-year return.

Sean McMahon, portfolio manager and research analyst, said in a phone interview that the strategy primarily benefited from its deep bench of 14 research analysts.

"A lot of these (microcap) names, they don't have a lot of analyst coverage. Typically, not a lot of people are calling them," Mr. McMahon said.

One example of a holding that helped drive outperformance was **Verso Corp.**, a manufacturer of paper and pulp products. Mr.

McMahon said that industry had been reducing capacity, and Kennedy Capital came to the conclusion that they may have overcorrected and took too much capacity out.

"Pulp prices just had an astronomical growth throughout 2021, especially in the first half," Mr. McMahon said.

Financial Trust Asset Management

Financial Trust Asset Management, Boca Raton, Fla., ranked third with its American disciplined small-cap strategy, which had a gross return of 67.78% for the year.

Arno O. Mayer, the firm's founder, majority partner, CEO, chief investment officer and chief compliance officer, said the firm and its strategies take a quantitative approach, and the disciplined small-cap strategy specifically utilizes a smart-beta model that uses 14 factors to rank names within each of the 11 individual sectors of the market.

"From those factors then, we basically keep the sector weight equal to the market," Mr. Mayer said, "and then once per quarter, the portfolio is rebalanced and reallocated."

Mr. Mayer noted that there are earnings growth factors within the portfolio, so it's not strictly a value-based portfolio.

The strategy benefited from a small position in **GameStop Corp.** during 2021, which accounted for half of the strategy's overall outperformance, but he noted "we still had another 20% in excess performance over the benchmark."

Donald Smith & Co. Inc., New York, had both the fourth- and fifth-ranked strategies for the year. The manager's microcap value strategy and small-cap value strategy returned a gross 64.88% and 61.74%, respectively, for the year ended Dec. 31.

Richard Greenberg, CEO and co-chief investment officer, said in a phone interview that they are traditional deep value investors.

"Our initial screens look primarily at value parameters, and our first screen is done with stocks that dwell in the lowest decile of tangible book to value," Mr. Smith said.

"Our founder Don Smith (who passed away in 2019), he had started in the 1960s and he (had) been using the same approach since then. We've been an independent firm since the early 1980s, and we always use that screen to find cheap stocks, and we do in-depth fundamental research."

The only difference between the microcap value strategy and small-cap value strategy is the market capitalization, Mr. Greenberg said, and they can share common holdings.

During the past year, the strategies have both benefited from investing in undervalued companies that would be taken over.

"We often use takeovers in our portfolio, whether it's by private equity or competitive companies who recognize the underlying asset values," Mr. Greenberg said. Some examples from the last year include hotel real estate investment trust **CorePoint Lodging Inc**. and Verso.

He also pointed out **Resolute Forest Products Inc.**, a company that benefited in 2021 from higher timber prices.

Growth dominates for 5 years

For the five years ended Dec. 31, seven of the top 10 strategies were growth-oriented. Four of those strategies fell within Morningstar's small-cap category, two were categorized as large-cap strategies and one as a midcap strategy. The other three top 10 strategies fell within Morningstar's technology category.

The overall median annualized return for domestic equities within the Morningstar separate account universe was 15.08% for the five years ended Dec. 31, compared with the Russell 3000 index annualized return of 17.9% for the period.

The median annualized return in Morningstar's universe for overall growth strategies was 21.13%, while the annualized median return for the period for overall value strategies was 11.8%.

The top performer for the five years ended Dec. 31 was Minneapolis-based Next Century Growth Investors LLC, with its microcap growth strategy chalking up an annualized gross return of 43.18%.

Robert Scott, president, partner and portfolio manager at Next Century Growth, said in a phone interview that research has been the primary reason the microcap strategy has had such a successful five years.

"We've been doing our own research with our internal team, and we feel like a small team of investment professionals working together conducting its own research is the best way to find these very special companies," Mr. Scott said. "We understand investing in small, fast-growing companies involves risk, and we'll make mistakes, and we're always constantly challenging our thoughts in exiting companies."

That involves a strong sell discipline when the firm believes the fundamentals demand it.

"We're trying to find those very unique, small, fast-growing companies that are going to be able to sustain those high growth rates for many, many years," Mr. Scott said.

While many fast-growing companies in the health-care and technology sectors have contributed to the historic outperformance, Mr. Scott said the strategy has also had a strong overweight in the financial sector over the past five years.

He noted the past five years have been a "wild period" macroeconomically, so it isn't as much those factors that have contributed to the outperformance but investing in companies that can thrive given constant "market gyrations." He declined to name specific companies.

The rest of the top five strategies for the five years ended Dec. 31 were: ARK Investment Management LLC's Next Generation Internet strategy, which had an annualized gross return of 42.66%; Zevenbergen Capital Investments LLC's Genea growth strategy, with a gross return of 40.62%; Morgan Stanley Investment Management's Discovery strategy, 37.68%; and Granahan Investment Management LLC's small-cap select strategy, 37.52%.

Within the collective investment trust universe for the year ended Dec. 31, nine of the top 10 domestic equity CITs were real estate securities strategies.

Leading all trusts was Wellington Management Co.'s CIF real estate securities trust, which reported a net return of 47.76%.

The median return of domestic equity collective investment trusts in Morningstar's universe for the year ended Dec. 31 was 25.06%.

For the five years ended Dec. 31, nine of the top 10 collective investment trusts were large-cap growth trusts, with one midcap growth trust included as well.

The top-ranked CIT for that period was the State Street Global Advisors' Nasdaq 100 Index Class A CIT, which had an annualized net return of 28.66%.

All data for *Pensions & Investments'* top-performing managers report are provided from Morningstar's global separate account/collective investment trust database. The data for the separate account rankings on which this story is based were pulled Feb. 10, and CIT data was pulled Feb. 4.

Next Century Growth Investors Micro Cap Growth product ranked #1 for the five year period ending 12/31/21 in the Overall U.S. equity separate account universe. *Source: Morningstar.*

NCG Next Century Growth Investors, LLC

Past performance is not an indicator of future performance and the value of your account may increase or decrease over time.