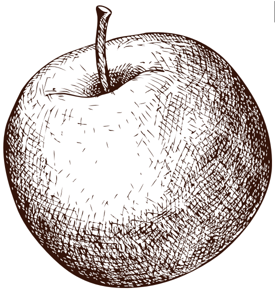
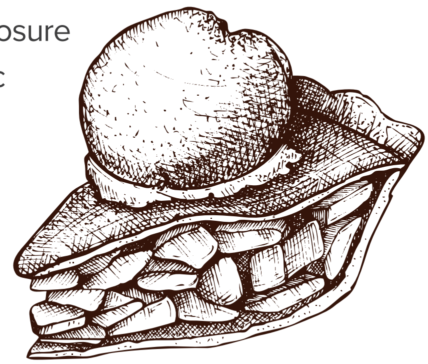
# HOW ARE YOU SLICING YOUR AMERICAN PIE?



Many investors use passives to gain exposure to the US market but more dynamic approaches can still gain an edge. What innovative active investments are you using to tap this highly competitive space?



## BUYERS' VERDICTS

### Ion Zulueta

**Arcano Partners, Spain**

In our clients' portfolios we hold two strong and complementary active managers who are focused mainly on the US market. They have been investing for more than two decades and have handsomely outperformed the stock market indices over the long term.

The first one is **Yacktman**, a value-oriented manager concentrating on buying quality businesses with a dominant position in their respective sectors and a shareholder-focused management. Its investment approach is only suitable for those who are able to remain invested over a full market cycle. Its alpha tends to coincide with bear markets, so at a time when market valuations are really stretched and value is so out of vogue, it seems more reasonable than ever to remain invested.

The second manager is **Alkeon**, a growth manager with expertise in technology-related sectors and companies. As opposed to Yacktman, Alkeon is a long/short fund but with a strong directional bias. It offers exposure to a rapidly growing segment of companies, but at the same time, it is very well protected on the downside, and makes use of put options in case there is a large market drawdown.

### Arnaud Bergeot

**ABN Amro Investment Solutions, France**

We believe we can find talented managers and analysts in independent boutiques which are employee-owned, where equity has to be distributed among the entire investment team in order to have an alignment of interest with their clients. We also favour strategies that are available in Europe, which follow a bottom-up and fundamental approach with a long-term investment horizon.

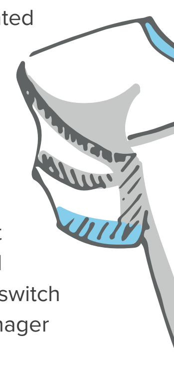
We typically prefer to invest in seasoned managers with a full market cycle track record, as markets can be impacted by different short-term events than the underlying fundamentals of the companies in the portfolio. The US stock market tends to be increasingly concentrated in the largest companies. Nevertheless, we like funds with a concentrated portfolio and a high active share because this approach should be able to generate alpha in the long run. However, the strategy's alpha has to be provable and reasonable given its risk profile. We spend hours with the entire investment team to understand their process and to determine whether it is repeatable or not.

The portfolio managers we favour are **Geeta Aiyer** of **Boston Common**, **Howard Gleicher** of **Aristotle**, **Patrick Kelly** from **Fred Alger** and **Todd Ahlsten** of **Parnassus**.

### Sandro Merino

**Basler Kantonalbank, Switzerland**

It is difficult to identify investment strategies which consistently outperform a large and liquid market such as US equities. Therefore, passives do play an important role. Nevertheless, we have found a number of fund managers who have been able to outperform the broad US equity market over an extended period. However, it is important to look at the factors which drive this outperformance. Our analysis shows these outperforming US equity funds usually have a growth bias, either because it is their dedicated style or because they happen to have positioned themselves with a tilt to growth companies. Growth stocks and the technology sector in particular are definitely favoured by the current low-growth, low-interest-rate environment, but investors must be aware that regime changes could occur. It might then be necessary to switch to another fund, unless the fund manager



has the flexibility and skill to reposition the portfolio. Since growth has dominated markets for such a long time, selectors will need to analyse a manager's investment process very carefully to determine whether they will have this ability to adapt.

## Florian Gröschl

**ARC Absolute Return Consulting, Austria**

As momentum starts to slow, it is time to take a more critical look at investments into passive products everywhere, but foremost in the US. As a sceptic of herd mentality, it seems the right moment to reconsider value approaches, especially on a relative basis.

A strong, comprehensive ESG process is paramount to many investors, particularly in Europe, but is still difficult to find US funds which tick this box. For this reason, we favour Coho Partners, based in Berwyn, Pennsylvania, which takes a conservative, quality approach.

The **Coho US Large Cap Equity** fund is embedded in the Candoris Icav and meets all European regulatory requirements. Coho combines an outstanding research and investment process with a proven track record over more than 20 years. It also has a consistent and comprehensive ESG process implemented since 2011.

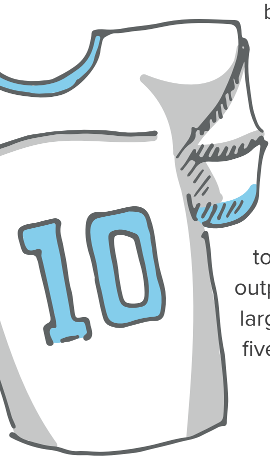
Sorry for sounding like your favourite sales guy but after recent developments markets finally seem to be waking up to the fact that their pricing is nowhere near reality.

## Jaime García-Morales

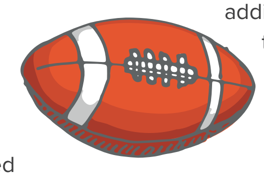
**MdF Family Partners, Spain**

These days, more than 50% of assets in US funds are represented by passives, and there seems little point in trying to beat a market that is so efficient and where any new information on stocks is incorporated into prices very quickly.

Furthermore, according to Spiva, the S&P 500 index outperformed 80.6% of active large-cap equity funds over a five-year basis.




With this in mind, you need to distinguish yourself from the index to gain an edge. If your portfolio looks like the index it will be impossible to beat it. Our strategy is to invest in a concentrated fund of about 20 stocks and also in a focused small-cap fund to gain a chance of outperformance over time. With this approach, investors have to accept there will be periods of underperformance but in a long run it will be worth it.



## Nicola Tommasini

**Anima, Italy**

Apart from being one of the most liquid and large markets in the world, the US is represented by many innovative listed companies in different sectors, that are able to capture different types of secular growth opportunities. However, it's hard to find good and consistent active managers in this space, which explains the increasing use of passives. We prefer to focus mainly on managers who have the skills and investment processes to identify stocks with sustainable growth, through in-depth fundamental research into growth opportunities and the quality of the business. By using these types of managers, we aim to outperform the market not just in absolute terms but also on a risk-adjusted basis, thanks to the better quality and less cyclical profile of their portfolios. The **Vontobel US Equity** fund is a good example of a strategy with these characteristics. It has a consistent and rigorous research process and is particularly focused on the long-term assessment of the quality and growth opportunities of companies, rather than short-term tactical openings. As well as using traditional approaches to evaluate a company's quality, the investment team also considers ESG factors, which we think are particularly relevant when building a concentrated and high-conviction portfolio. Other good examples are the **Mirabaud Sustainable Global Focus** and **Morgan Stanley Global Quality** funds, which are global equity funds we have selected to additionally tap the US market. We also like the **Anima US Equity** fund, which employs strong internal expertise in this space.

## Stephen Pau

**Hefeng Family Office, Hong Kong**

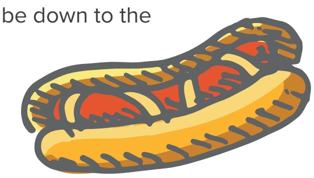
The outbreak of Covid-19 has prompted companies to pay more attention to the importance of technological development, which has become the main engine of economic growth. The pandemic has undoubtedly accelerated technology and software investment as consumer behaviour starts to shift online.

We like mutual funds that choose companies which are doing well in this space and at the same time follow an ESG philosophy. These companies tend to have good growth prospects and earn high market valuations, which in turn attract more capital inflows. In the context of the Covid-19 pandemic and recent demonstrations in the US, we have noticed that companies focused on ESG have better corporate competence in controlling risks and are more inclined to have a long-term stable growth development. A fund we like with this in mind is the **Schroder ISF Global Sustainable Growth** strategy which has a YTD performance of 12%. Its US exposure hovers around 40% but is more defensive in nature as it incorporates ESG elements in the selection process for its fund constituents.

## Jakub Wojciechowski

**mBank, Poland**

Investing in the biggest and the most competitive equity market poses a real challenge for active investors. We are aware that many funds in this category have little chance to catch up with the benchmark and this is not always due to a lack of skill, but can be down to the restrictions placed on the strategy such as high



management fees, hugging a benchmark and investment limits. Therefore, the first step in fund selection for me is to exclude strategies of this type. This significantly limits the group of potential funds on offer, especially in the US large-cap category. Nevertheless, I assume that a well-diversified portfolio should also include an active part.

We are looking for funds that have a well thought-out investment process, a stable and experienced management team and the mandate to take a clear market bet. There are also some soft issues that might be of importance, such as the quality of service in communication with clients, which often comes in handy in crisis situations. One example of a strategy with a broad investment spectrum is the **AB American Growth Portfolio**, where **Frank Caruso** is lead manager.

## Cameron Falconer

**Aviva Investors, UK**

The US is home to hundreds of companies developing game-changing products and services, so it is often perplexing that so many US equity managers concentrate on a handful of widely-held large-cap stocks. Some of the most attractive and under-appreciated opportunities are further down the market cap spectrum in names enjoying structural growth tailwinds. Certain small-cap managers are adept at identifying beneficiaries of the structural changes accelerated by Covid-19 in areas such as online retailing, telemedicine, digital learning and remote working. Being on the right side of disruptive change is important, but we need to ensure that those managers understand the business drivers and the industry dynamics that will determine whether these businesses can continue to grow into often lofty valuation multiples. Careful consideration should also be given to the risk/reward profiles in position sizing and overall portfolio construction.

## John Mallon

**Classis Capital, Italy**

Passive definitely has the momentum, but it's worth pointing out that with the huge proliferation of indices tailored for passive products, the lines between active and passive are increasingly blurred. The passive universe now has everything from simple smart beta to senior loans or even merger arb strategies, so the due diligence on index construction is vital and also time consuming, so passive can be a very active choice.

However, not to get too deep into the weeds and to answer the broad question, we do use a combination of active and passive strategies to access the US market, with most of our passive allocation in equities. But one active strategy that has done well for us is the **DoubleLine Shiller Enhanced Cape** fund.

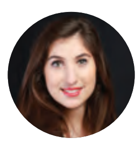
The investment approach has some similarities with synthetic passive strategies, in that there is an index which is replicated through a swap while the collateral is invested in the market. In this case, professor Robert Shiller and DoubleLine have created the Cape index, which is based on the Shiller's Cape ratio, and is designed to replicate large-cap US equity exposure.

The fund's return has two components, one from Shiller's Cape index and the other from the collateral which is invested in an active fixed income portfolio managed by Jeffrey Gundlach's DoubleLine. We are aware that this fund is a marketing dream but there are also many moving parts, so it is important to be comfortable with the fund's exposures, such as the concentrated nature of the index, the derivatives and also the credit component. For us, this strategy is a complement to our other US equity strategies and we've been happy with its long-term performance.

When it comes to fixed income and other hybrid asset classes the index construction can be sub-optimal due to cap-weighting which leads to the index loading up on the most heavily indebted issuers. This point of contention is often referred to as the 'bums problem'.

One active fund in the hybrid space that has performed well for us over several years is the **Polar Capital Global Convertible** fund. The strategy has a global remit but due to the dominance of US companies in the convertibles market it has more than 60% allocation to the US.

The management's judgement is key as the embedded option adds to the volatility so it's important to balance the portfolio along the option curve and not load up on in-the-money bonds. We like Polar's more defensive approach and it has been a solid performer through this recent market chaos.



## Pauline Tuccella

**Haas Gestion, France**

Outperformance is critical for us, especially during periods of market stress where active managers can improve risk-adjusted returns. We invest in equity funds where stock selection is the main driver of performance, and when it is about alpha the **Morgan Stanley US Advantage** fund springs to mind. Aside from generating strong long-term results, this fund is concentrated and sector-agnostic in nature. However, we think active management is more profitable for US smid caps, and we rely more on active strategies in this market segment that are less subject to international competition and handled primarily on a domestic basis, such as the **Artemis US Smaller Companies** fund.

Nevertheless, in the current investment climate we are combining passive and active investment strategies.

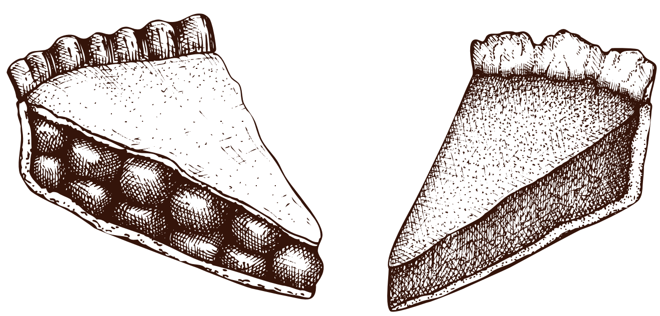
Another way to access the US market is through a quantitative strategy such as a systematic option on a selection of US equities in order to generate income and benefit from liquid US stocks with a sustainable business model.

## SPOTLIGHT ON SELECTORS' PICKS

With a wide array of funds on the cards this month, Morgan Stanley did particularly well, with two separate strategies highlighted by fund pickers. The **Morgan Stanley Global Quality** fund was earmarked as a way to gain US exposure via a broader remit, while the **Morgan Stanley US Advantage** fund, as mentioned by Pauline Tuccella, has a region-specific focus.

This latter fund has a stellar manager line-up including Citywire AAA-rated duo Dennis Lynch (pictured) and Sam Chainani along with Citywire + rated David Cohen. The $12.1bn strategy has a strong emphasis on IT, which accounts for about 40% of the portfolio versus a 27% weighting in the benchmark. This bias is reflected in the trio's top stock picks, with Shopify, Square and Amazon occupying primary positions.

The fund's June update – the most recent available at the time of going to press – shows how the managers are focused on value-oriented opportunities where possible. The fund's most recent strong performance, which has pushed it into the top 50 funds in the Equity – US sector over a three year basis, was aided by its IT overweight but also by exposure to communications, industrials and healthcare-related stocks.



## *Citywire Verdict*

**Chris Sloley**, Editor

The famously tough US market comes across a bit like Everest in this month's Buyers' Market. Many of those who responded want to take it on because it is there to be conquered but the majority highlighted how the power of passives is hard to pass up.

For those who are willing to go the active route, there are several common considerations. First, find a manager with long-term credentials. Second, find out how they are positioned along the growth/value divide and, finally, cast a wide net to uncover potentially unknown talent.

Several of the names featured in this month's round-up are from fund houses I have had limited interaction with or don't know at all. The likes of Coho Partners, headquartered in Pennsylvania, and Boston Common, Aristotle and Parnassus are not exactly household names within the European market.

The growth/value question was a prominent one, with the received wisdom being that growth-oriented ideas have been the frontrunner for some time. This is particularly true for technology and disruption stocks, as highlighted by Aviva Investors' Cameron Falconer. However, Florian Gröschl said that may be changing and now is the time to review your value-focused ideas to steal a lead on the herd mentality if – and when – there is a rotation.

One approach which featured in several of these contributions is the idea of limiting direct exposure to the US by deploying a global equity fund with a heavy bias to the States. Nicola Tommasini of Anima, Hefeng Family Office's Stephen Pau, and Classis Capital fund picker John Mallon all gave examples where a more macro approach makes the more sense.

Jakub Wojchiechowski added an interesting take on the question, highlighting the need to locate a US group that can deliver on the 'soft issues', namely communication and transparency. With one eye on how tough the market has been over the past year, he made the point that having open access to US groups can be vital at the best of times but never more so than the last year.

## SELECTORS' FAVOURED FUNDS

| Fund | Manager | Citywire rating |
|---|---|---|
| AB American Growth Portfolio | Vinay Thapar, Frank Caruso, John Fogarty | CITYWIRE A (Thapar) CITYWIRE + (Caruso, Fogarty) |
| Alkeon | n/a | n/a |
| Anima US Equity | Carla Scarano | CITYWIRE + |
| Artemis Small Companies | Cormac Weldon | CITYWIRE AA |
| Coho US Large Cap Equity | n/a | n/a |
| DoubleLine Shiller Enhanced Cape | Jeffrey Sherman, Jeffrey Gundlach | n/a |
| Mirabaud Sustainable Global Focus | Paul Middleton, Anu Narula | CITYWIRE A (Narula only) |
| Morgan Stanley Global Quality | n/a | n/a |
| Morgan Stanley US Advantage | Sam Chainani, Dennis Lynch, David Cohen | CITYWIRE AA (Chainani, Lynch) CITYWIRE + (Cohen) |
| Polar Capital Global Convertible | David Keetley, Stephen McCormick | CITYWIRE + |
| Schroder ISF Global Sustainable Growth | Charles Somers, Katherine Davidson | CITYWIRE AA |
| Vontobel US Equity | Matthew Benkendorf | CITYWIRE A |