

SPECIAL REPORT Top Performing Managers

Small-cap strategies continue win streak in latest quarter

By Meaghan Kilroy

For the fifth consecutive quarter, small-cap equity strategies dominated Morningstar Inc.'s domestic equity separate account/collective investment trust database, occupying six of the top 10 spots for the year ended Sept. 30.

Four of the six were growth strategies, one was value and the other was a financial value strategy.

Last quarter, there were seven small-cap equity managers in the top 10 for the year ended June 30, including four growth managers.

Rounding out the rest of the top 10 this time were a large-cap growth technology strategy, a midcap growth technology strategy, a multicap growth technology strategy and a midcap blend strategy.

"A fair amount of (small-cap equity) strategies are doing particularly well considering the environment we're in," said Andrew Daniels, analyst for equity strategies at Morningstar in Chicago. Small-cap stocks receive less of their earnings from non-U.S. markets and the possibility of lower corporate U.S. tax rates, for instance, has served as a boost, Mr. Daniels said.

The year has also been at odds with what did well near the end of 2016, Mr. Daniels said. "If you remember after the election of 2016, value did a lot better than growth. In 2017, both for large caps and small caps, growth has outperformed value," he said.

For the 12 months ended Sept. 30, the Russell 2000 Growth index returned 20.98% and the Russell 1000 Growth index, 21.94%, surpassing the Russell 2000 Value index and Russell 1000 Value index, which returned 18.27% and 15.12%, respectively.

Small-cap domestic growth and value equity strategies in Morningstar's database, meanwhile, returned a median 21.87% and 20.46%, respectively, and large-cap domestic growth and value equity strategies, 19.77% and

SMALL GROWTH

	1 year gross return	1 year net return
Kayne Anderson Rudnick SC Quality Select	72.84	70.82
Granahan Inv Mgt Small Cap Discoveries	40.35	39.41
Weatherbie Capital "Spec Gr Eq	35.33	34.39
Kayne Anderson Rudnick SC Sustain Growth	35.07	33.78
Oberweis Micro-Cap Growth	34.68	33.67
RS Small Cap Growth	33.67	32.48
Granahan SC Advantage	32.96	32.39
Baron Discovery Strategy	32.85	31.75
Scout Small Cap Equity	32.52	31.42
Conestoga Small Cap Growth	31.93	31.15

SMALL GROWTH

	5 year gross return	5 year net return
BMO Microcap Equity - Institutional - SA	21.51	20.29
Oberweis Micro-Cap Growth	20.93	19.91
Kayne Anderson Rudnick SC Sustain Growth	20.83	19.65
Friess Small Cap Growth	19.96	18.84
Renaissance Small Cap Growth	19.45	18.77
Granahan Inv Mgt Small Cap Discoveries	19.21	18.69
Brown Capital Small Company Service	19.76	18.67
US Equity Small Cap Core	18.91	18.06
Essex Inv Mgt Micro Cap Growth	18.97	17.73
Jacobs Levy Sm Cap Gr (R 2000 Gr)	18.70	17.72

Source Morningstar. Returns as of September 30, 2017. Source Morningstar

16.72%, respectively. Overall, domestic equity strategies in Morningstar's universe returned a median 18.83% for the same period, domestic growth, 20.1%, and domestic value, 17.82%.

Occupying the No. 1 spot for the year ended Sept. 30 by a wide margin was the Kayne Anderson Rudnick Small-Cap Quality Select strategy with a gross return of 72.84%. Todd Beiley, portfolio manager and senior research analyst, described the Los-Angeles based firm as "fundamental bottom-up investors" that seek to own businesses with "very effective competitive barriers and good economics." The

quality select strategy, a more focused version of the firm's other small-cap equity strategies, held six securities as of Sept. 30.

The top contributor for the year ended Sept. 30 was Autohome Inc., an online source for automotive information in China that receives most of its revenue through advertising and subscriptions from dealers.

Mr. Beiley said a management change in early 2016 resulted in the company exiting a segment of its business that was not as successful — selling cars directly to consumers. Since new management stepped in,

the company's core business has improved and profits "have increased pretty dramatically," Mr. Beiley said.

Autohome was up 147.75% for the year ended Sept. 30.

Another strong performer was specialty food distributor Chefs' Warehouse, which was up 73%, Mr. Beiley said. The company made some acquisitions that were problematic but is moving past those challenges and profitability is improving, he said.

Another one of the firm's small-cap growth strategies — Kayne Anderson Rudnick Small Cap Sustainable Growth — ranked eighth on the one-year list with a gross return of 35.07%. Unlike quality select, the sustainable growth strategy owns around 30 securities at a time. Top contributors were Autohome and National Resource Corp., which provides patient surveys to hospitals.

Occupying the third spot on the one-year list was the Crabtree Multi-Cap Technology strategy, with a gross return of 40.62%.

Barry Randall, chief investment officer at Crabtree Asset Management in St. Paul, Minn., said it's a quantitative equity strategy. Three criteria Mr. Randall looks for when deciding whether to invest are companies that are executing their operational and financial plans, have experienced positive operating cash flow for at the least the trailing 12 months, and are holding onto or growing their market share. The portfolio aims to own 50 securities at all times and every position starts at 2%.

"All aspects of technology have worked over the last 12 months," Mr. Randall said. While the portfolio tends to "skew (toward) smaller cap in general," both large-cap and small-cap technology stocks in general have done well over the past 12 months, he said.

"The perception that any Trump administration tax policy will benefit many of the technology companies," has been a tailwind for technology stocks, Mr. Randall said.

Also, "the comfort level with online commerce and online anything really, has never been higher," he said.

Green Dot Corp., a prepaid debit card issuer; Control4 Corp., a smart home automation system developer; and MKS Instruments Inc. were some of the portfolio's top performers.

Behind Crabtree was the Granahan Investment Management Inc. Small Cap Discoveries growth equity strategy with a gross return of 40.35%. Gary Hatton, co-founder and CIO of the Waltham, Mass., firm, said the investment team looks for small- and microcap

OVERALL U.S. EQUITY

	Category	1 year gross return	1 year net return
Kayne Anderson Rudnick SC Quality Select	U.S. SA small growth	72.84%	70.82%
ZPR Volume Value	U.S. SA financial	42.56%	40.23%
Crabtree Multi-Cap Technology	U.S. SA technology	40.62%	39.73%
Granahan Small Cap Discoveries	U.S. SA small growth	40.35%	39.41%
Zevenbergen Z/Tech	U.S. SA technology	39.82%	38.63%
Pacific Ridge Capital Micro Cap Value	U.S. SA small value	38.21%	35.55%
RS Technology Composite	U.S. SA technology	37.72%	36.36%
Kayne Anderson Rudnick SC Sustain Growth	U.S. SA small growth	35.07%	33.78%
Oberweis Micro-Cap Growth	U.S. SA small growth	34.68%	33.67%
The Boston Opportunistic Investor	U.S. SA midcap blend	34.43%	28.45%

Source Morningstar. Returns as of September 30, 2017. Source Morningstar

companies with "staying power," which ties to qualities like strong balance sheets, good management, being in a good competitive position, and gaining market share.

The strategy typically contains between 65 and 80 holdings. Health care, specifically companies specializing in gene therapy, was a strong performer for theyear ended Sept. 30, Mr. Hatton said.

Some of the more economically sensitive growth names in trucking and shipping have also performed well, along with technology companies involved with the cloud, cyber security or power solutions for electronic products, Mr. Hatton said.

The remaining strategies of the top five on the one-year list were carryovers. ZPR Investment Management Inc.'s Volume Value strategy ranked second with a gross return of 42.56%, and Zevenbergen Capital Investments LLC's Z/Tech strategy ranked fifth with a gross return of 39.82%. Last quarter, the Volume Value strategy, which invests in microcap stocks with attractive valuations and low trading volume relative to total shares outstanding, ranked second; Z/Tech, a concentrated growth portfolio that looks for companies that are disrupting industries, ranked third.

Z/Tech and ZPR Volume Value also ranked first and third, respectively, on the five-year list, unchanged from last quarter. Z/Tech returned an annualized gross 26.36% over the five years ended Sept. 30, and Volume Value, 24.8%. All five-year returns are annualized.

The rest of the top five ranking was also unchanged from last quarter for the five-year returns: Naylor & Co.'s core composite midcap growth strategy was in second place with a gross return of 26.05%; Pacific Ridge Capital Partners LLC's microcap value strategy in

fourth place with a gross return of 22.57%; and Wellington Management Co. LLP's Global Technology Opportunities in fifth with a gross return of 21.7%.

The median return for Morningstar's overall domestic equity universe for the five years ended Sept. 30 was 14.17%.

For domestic collective investment trusts, the BNY Mellon Investment Management's EB DO large-cap core strategy ranked first on the one-year list with a net return of 51.48%, followed by J.P. Morgan Asset Management (JPM)'s large-cap growth strategy with a net return of 27.11%; JPMAM's growth advantage strategy, 26.67%; JPMAM's U.S. active value fund, 25.74%; and William Blair & Co. LLC's smidcap growth strategy, 25.55%.

The median return for domestic collective investment trusts for the year ended Sept. 30 was 18.61%.

For the five-year period, the highest returning CIT was JPMAM's growth advantage strategy with a net return of 18.17%, followed by BNY Mellon's large-cap core strategy at 18.08%; State Street Global Advisors' Nasdaq-100 index strategy, 17.88%; BNY Mellon's EB DV dynamic U.S. equity strategy, 17.35%; and Wellington Management's CIF II small-cap opportunities strategy, 17.28%.

The median return for domestic collective investment trusts for the five-year period was 14.22%.

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 rankings on which this story is based were pulled Oct. 25.

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