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SPECIAL REPORT

Top Performing Managers

Small-cap equity strategies give way to large cap, technology in latest quarter

By James Comtois

After five consecutive quarters of small-cap strategies dominating Morningstar Inc.'s domestic equity separate account/collective investment trust database, large-cap and technology approaches reigned supreme for the year ended Dec. 31.

Four of the top 10 strategies were large cap, while four were technology strategies. Meanwhile, only two were small cap, after six had been in the top 10 for the year ended Sept. 30.

"It was much more of a large-cap driven year in 2017, although there was some strength in small growth," said Tony Thomas, manager research analyst, equity strategies at Morningstar, Chicago. "Anybody that had exposure to technology also fared well in 2017."

Mr. Thomas explained that after the U.S. presidential election, investors were more willing "to move to risk-on rather than risk-off." In previous years, investors were more drawn to utilities and bond-like equities. But in 2017, there was a lot more openness to risk, he said.

Plus, investors were more aware of the disruptive nature of technology companies and their potential, Mr. Thomas said.

After having a pretty rough first nine months in 2017, there was some improvement in the consumer sectors. Some of these strategies did well with e-commerce. However, despite the success with e-commerce firms, some of these strategies also benefited from traditional brick-and-mortar firms, such as Walmart Inc., which Mr. Thomas said had a great quarter.

"There was a lot of talk about semiconductors and chip-makers in 2017," Mr. Thomas added.

Overall U.S. equity

ONE-YEAR RETURN	Category	Gross return	Net return
Kayne Anderson Rudnick SC Quality Select	U.S. SA small growth	65.72%	63.74%
Zevenbergen Z/Tech	U.S. SA technology	52.50%	51.21%
Morgan Stanley (MS) Multi Cap Growth	U.S. SA large growth	49.85%	48.41%
RS Technology Composite	U.S. SA technology	46.72%	45.26%
Allianz Global Technology Equity	U.S. SA technology	46.04%	44.65%
Marsico Non-Taxable Select Alpha Growth	U.S. SA large growth	45.42%	43.07%
Morgan Stanley Growth	U.S. SA large growth	44.97%	43.94%
Elemental Capital Focused Growth	U.S. SA large growth	44.60%	43.41%
Next Century Growth Small Cap Ultra	U.S. SA small growth	44.10%	43.11%
Wellington Global Technology	U.S. SA technology	43.54%	42.48%

FIVE-YEAR RETURN	Category	Gross return	Net return
Zevenbergen Z/Tech	U.S. SA technology	28.57%	27.41%
Naylor & Company Core Composite	U.S. SA midcap growth	25.56%	22.92%
ZPR Volume Value	U.S. SA financial	25.07%	23.03%
Wellington Global Technology Opps	U.S. SA technology	23.64%	22.72%
RS Technology Composite	U.S. SA technology	23.51%	22.29%
Oberweis Micro-Cap Growth	U.S. SA small growth	22.59%	21.57%
Allianz Global Technology Equity	U.S. SA technology	22.28%	21.16%
Wellington Global Technology	U.S. SA technology	22.13%	21.23%
Friess Small Cap Growth	U.S. SA small growth	21.99%	20.89%
Kayne Anderson Rudnick SC Sustain Growth	U.S. SA small growth	21.76%	20.58%

The Morningstar analyst also noted that the energy sector "was down in the year but picked up a bit in the fourth quarter."

Overall, domestic equity strategies in Morningstar's universe returned a median 19.47% for the year. For the 12 months ended Dec. 31, the Russell 3000 returned 21.13%.

Morningstar's median return for domestic equity growth strategies for the year ended Dec. 31 was 25.03%. Meanwhile, the median return for domestic equity value strategies for the year was 15.62%.

Once again, Kayne Anderson Rudnick's Small-Cap Quality Select strategy occupied the No. 1 spot for the year ended Dec. 31 — and again, by a wide margin — with a gross return of 65.72%.

The strategy continued to do well with Autohome Inc., an online source for automotive information in China that receives most of its revenue through advertising and subscriptions from dealers, Mr. Thomas said. Autohome was up 188.2% for the year ended Dec. 31.

Zevenbergen Capital Investments LLC's Z/Tech strategy, a concentrated growth portfolio that looks for companies that are disrupting industries, ranked second on the one-year list, with a gross return of 52.5%.

Joseph Dennison, associate portfolio manager at Zevenbergen, attributed the success of the strategy to the continuation of its high-conviction, high-growth strategy.

"We focus on rapidly growing companies with strong technological advantages," Mr. Dennison explained. "Those companies were certainly rewarded in 2017 and in the fourth quarter."

He cited Mercadolibre Inc., an Argentina-based e-commerce company, as one of the strategy's top-performing stocks.

"As a dominant player in the infrastructure in Latin America, they saw growth accelerate in 2017 in the region and gained the lion's share of the benefit," Mr. Dennison said of Mercadolibre.

Z/Tech also ranked first on the five-year list, unchanged from last quarter, with an annualized gross return of 28.57% over the five years ended Dec. 31.

Morgan Stanley (MS) Investment Management had two of its large-cap growth strategies make the one-year list this quarter — its Multi-Cap Growth strategy, at No. 3, with a gross return of 49.85%; and its Growth strategy, at No. 7, with a gross return of 44.97%.

Managers that had exposure to technology stocks also fared well last year, said equity research analyst Tony Thomas of Morningstar.

"It was a strong year in the market, and the funds did particularly well," said Dennis Lynch, head of growth investing at Morgan Stanley Investment Management. "Our strategy is to make good long-term decisions. And if you're doing that, you'll have pockets of strong outperformance."

Mr. Lynch said "there was a lot of market rotation and stock-specific volatility" after the election, which "hurt the funds for a short period of time."

And Mr. Lynch explained that although the company doesn't typically make tactical changes every year, MSIM took this volatility as an opportunity to get more concentrated in technology stocks, which wound up paying off, with many internet companies up more than 50%.

"We benefited from our positions in those areas and got aggressively positioned in those areas at the end of 2016," Mr. Lynch said. "We thought the risk-rewards were very compelling."

Mr. Lynch attributed the bounce back in these stocks "to good strong fundamental performance from those companies in addition to the strong market tailwind."

The RS Technology Composite strategy managed by Victory Capital Management Inc. ranked fourth, returning a gross 46.72%. The strategy seeks to invest in companies that either use technology to create competitive advantages or benefit from the application of technological developments. The strategy also ranked fifth in the five-year returns with an annualized gross return of 23.51%.

Allianz Global Investors' Technology Equity strategy ranked fifth for the year with a 46.04% gross return.

"We're a technology fund, and we focus on both the semiconductor industry and cloud computing industry, and both of those sectors have done well," said Walter Price Jr., a managing director and senior portfolio manager with Allianz Global Investors. He is co-lead portfolio manager of the Technology Equity strategy.

"The growth rate is accelerating. It's attracted investors to both sectors quite a bit. Pricing and growth has been better than expected in the cloud computing sector," Mr. Price said, adding that the company "rotated a little bit from semiconductors and more into cloud computing, so we got that transition right."

The strategy experienced an annualized gross return of 22.28% for the five years ended Dec. 31, which ranked it seventh on the five-year list.

The median return for Morningstar's overall domestic equity universe for the five years ended Dec. 31 was 15.13%.

Naylor & Co.'s Core Composite midcap growth strategy followed the Z/Tech strategy in second place on the five-year list, with a gross return of 25.56%; ZPR Volume Value managed by ZPR Investment Management Inc. ranked third, with a gross return of 25.07%; Wellington Management Co. LLP's Global Technology Opportunities was in fourth with a gross return of 23.64%.

All five-year returns are annualized.

For domestic collective investment trusts, BNY Mellon Investment Management's EB DO large-cap core strategy ranked first on the one-year list with a net return of 56.56%, followed by Wellington Management's CIF II growth strategy, at 35.68%; BlackRock (BLK)'s U.S. fundamental large-cap growth strategy, 34.97%; Loomis, Sayles & Co.'s large-cap growth trust, 33.47%; and TCW's concentrated core fund, 32.96%.

The median net return for domestic collective investment trusts for the year ended Dec. 31 was 19.07%.

For the five-year period, the highest returning CIT was State Street Global Advisors' Nasdaq-100 index strategy, with a net return of 20.64%, followed by BNY Mellon Investment Management's EB DO large-cap core strategy, 19.9%; BNY Mellon's EB DV dynamic U.S. equity strategy, 19.35%; Wellington Management's CIF II growth strategy, 17.93%; and Wellington's CIF II small-cap opportunities strategy, 17.89%.

The median return for domestic collective investment trusts for the five-year period was 15.29%.

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