

Personal Finance

Yacktman Defies Demise of Stock-Picking Era

Donald Yacktman, whose Yacktman Focused Fund (YAFFX) has won \$1.5 billion in net deposits this year, is doing something rivals Bruce Berkowitz and Bill Miller aren't: making money for his clients.

Yacktman's fund beat 96 percent of peers in 2011 and at least 95 percent for the past five and 10 years, according to Morningstar Inc. (MORN) Excluding small-cap managers and those with less than \$200 million in assets, the only diversified U.S. stock funds to equal that mark as of Oct. 21 are his flagship Yacktman Fund, Artisan Mid Cap Value Fund, Wells Fargo Advantage Growth Fund, First Eagle U.S. Value Fund and SunAmerica Focused Dividend Strategy Portfolio.

"They may not be easy to find, but there are some top managers who can still outperform," Ronald Sugameli, chief investment officer of Weston Financial Group Inc. in Wellesley, Massachusetts, said in a telephone interview. His firm oversees \$1.6 billion and invests in actively managed funds.

The six funds are still attracting customer deposits while many competitors grapple with redemptions and some of the biggest-name managers face mounting losses. Investors have pulled \$349 billion from actively managed U.S. equity funds since the end of 2006, Morningstar data show, as two bear markets in the last decade shook their faith in stock pickers. The winning funds steered clear of this year's 23 percent decline in bank stocks, based on the KBW Bank Index.

The struggles of Berkowitz and Miller, who run funds that are down more than 25 percent in 2011, reinforce the view that stock picking doesn't work as well as

index investing in the long run, said Geoff Bobroff, an industry consultant.

SEEING NO VALUE

"People have thrown up their hands," Bobroff said in a telephone interview from East Greenwich, Rhode Island. "They don't think they can find enough managers who add value."

All six of the consistently strong funds have posted gains of at least 4.1 percent a year since the industry redemptions began in 2007, while the Standard & Poor's 500 Index has lost an average of 0.4 percent.

Berkowitz's \$8.9 billion Fairholme Fund fell 26 percent this year through Oct. 21 with wrong-way bets on banks such as Charlotte, North Carolina-based Bank of America Corp. (BAC), down 50 percent in 2011. Berkowitz was named domestic stock fund manager of the decade last year by Morningstar, the Chicago-based research firm.

Miller's \$964 million Legg Mason Capital Management Opportunity Trust (LMOPX) slumped 33 percent this year, hurt by declines in financial companies, including New York-based Citigroup Inc., which is down 33 percent. Miller's larger fund, the \$2.8 billion Legg Mason Capital Management Value Trust (LM-VTX), bested the S&P 500 for a record 15 straight years through 2005. That fund lost 5 percent this year.

AVOIDING BANKS

"There is no area we have spent more time looking at and not buying than banks," James Kieffer, co-manager of the \$6.2 billion Artisan Mid Cap Value Fund, said in a telephone interview from Milwaukee.

The fund, which owned no banks as of June 30, according to data compiled by Bloomberg, has avoided the group because there is a "high risk of bad things occurring," Kieffer said.

Yacktman, whose \$3.7 billion Focused Fund owned shares of Minneapolis-based U.S. Bancorp. and New York-based Bank of New York Mellon Corp. (BK) as of Sept. 30, has shunned most large banks because they're difficult to analyze, he said.

"They create assets with a stroke of a pen and it takes five years to find out how good the assets are," Yacktman, 70, said in a phone interview from Austin, Texas.

TOP TWO SPOTS

Yacktman Focused rose 5.2 percent in 2011, better than 96 percent of large-cap value funds, Morningstar data show. Over 10 years it returned 13 percent annually, the best showing among more than 500 comparable funds. The firm's flagship Yacktman Fund ranks second with an average gain of 12 percent.

Yacktman has used the same method to evaluate stocks since opening the Focused fund in 1997. He estimates how much cash a company will produce relative to what he has to pay for it per share. Macroeconomic issues are "fun to talk about" while offering little use in deciding which stocks to own because forecasting the economy's future is too difficult, he said.

Yacktman's approach hurt him in the late 1990s when he refused to buy technology stocks he considered overpriced. The fund lost 22 percent in 1999, compared with a gain of 21 percent for the S&P 500 Index.

Two tech names, Microsoft Corp. (MSFT) and Cisco Systems Inc. (CSCO),

are among the fund's biggest holdings today.

'WOULD HAVE LAUGHED'

"If someone had told me 10 years ago that these stocks would be in my portfolio I would have laughed," Yacktman said.

The former high-fliers have fallen so far that they're now attractive, he said. Redmond, Washington-based Microsoft lost about half its value since 1999. Cisco, based in San Jose, California, is down more than 70 percent.

Yacktman also holds a number of large, relatively stable stocks such as Atlanta-based Coca-Cola Co. (KO)

"I have been in this business 40 years and I can't remember a time when so many quality companies were selling at low prices compared to alternatives," he said.

Tom Ognar, who co-manages the only growth fund among the five steady performers, had 6.6 percent of the \$6.4 billion Wells Fargo Advantage Growth Fund in Apple Inc. (AAPL) as of Aug. 31, making it his largest position.

Apple has what Ognar looks for, he said: its earnings are growing at a fast, sustainable rate and the stock is inexpensive compared with the company's profit prospects.

'CHEAP' APPLE

"People say the stock is near an all-time high so it can't be cheap, but it is," Ognar, 41, said in a phone interview from Menomonee Falls, Wisconsin. Apple, which surged to a record \$422.24 on Oct. 18, gained 26 percent this year.

Apple, based in Cupertino, California, trades at 12 times estimated earnings for the next 12 months, about half its average multiple over the past five years, Bloomberg data show.

Ognar's fund climbed 8.5 percent this year, better than 99 percent of large-cap growth competitors, Morningstar data show. The fund beat 99 percent of peers over 5 and 10 years.

"It is too risky to make big macro bets," he said. Ognar and his team buy few bank stocks because it is hard to judge how much credit risk banks are taking, he said.

Artisan Mid Cap Value Fund (ARTQX) topped 99 percent of rivals over the past 10 years in part because it has performed well in volatile climates, Kieffer said.

"When markets shift from risk-seeking to risk-fearing, our stocks go down less," he said.

CUSHIONING BEAR MARKETS

The fund outperformed the Russell Mid-cap Index, one of its benchmarks, by 14 percentage points in the two worst stock market years of the past decade, 2002 and 2008.

Kieffer, 46, attributes the success to the fund's emphasis on "bottom-up" stock picking and the balance-sheet strength of its investments. The fund beat 98 percent of rivals in 2011, Morningstar data show.

Cigna Corp. (CI), one of the biggest holdings, gained 24 percent this year, Bloomberg data show. The Philadelphia-based medical insurer has rallied, Kieffer said, because "the reality of national health-care reform doesn't look as harsh as people initially thought."

The \$1.4 billion First Eagle U.S. Value Fund also beat its benchmark, the S&P 500 Index, in 2002 and 2008.

The fund didn't own technology stocks in 2002 or financial shares in 2008 as those industries were sold off, according to Matt Lamphier, associate portfolio manager.

AVOIDING 'PERMANENT IMPAIRMENT'

"We avoided permanent impairment," Lamphier, 43, said in a phone interview from New York. First Eagle beat 96 percent of peers in 2011 among funds that hold a mix of growth and value stocks, Morningstar data show.

The managers look for stocks selling at a discount of at least 30 percent to the price an all-cash buyer would pay for the business, Lamphier said. When they can't find enough companies they like, they hold cash.

The fund stashed 16 percent of its assets in cash and 8.3 percent in gold-related investments as of Sept. 30, according to the First Eagle website.

"Gold is a source of stability," Lamphier said of the longtime holding, seen as a haven in times of tumult.

FirstEnergy Corp. (FE), an Akron-Ohio utility and the fund's fourth-biggest stock position, advanced 23 percent this year. The company can increase earnings as the price of natural gas climbs, Lamphier said.

The \$987 million SunAmerica Focused Dividend Strategy Portfolio picks stocks only once a year. The managers select 10 from the Dow Jones Industrial Average with the highest dividend yields and 20 from the Russell 1000 Index based on valuation and profitability as well as payouts.

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The fund doesn't hold utility or financial companies, which it considers bond substitutes.

"Not owning financials has contributed mightily to performance," Timothy Pettee, 53, chief investment officer for SunAmerica Asset Management Corp., said in a phone interview from Jersey City, New Jersey.

The fund beat 98 percent of large-company value competitors this year with a return of 6.1, Morningstar data show, aided by gains in tobacco holdings. Lorillard Inc. (LO), based in Greensboro, North Carolina, and Reynolds America Inc., in Winston Salem, North Carolina, surged 40 percent and 21 percent, respectively.

The top stock pickers have all attracted deposits in 2011 even as active funds head for a fifth consecutive year of redemptions.

Yacktman Focused and the \$5.8 billion Yacktman Fund (YACKX) reaped a combined \$3.6 billion in the first nine months, according to Morningstar. Investors withdrew \$4.7 billion from Fairholme Fund and \$1.5 billion from Miller's two funds.

Most stock pickers face considerable hurdles winning back skeptical investors, Bobroff said.

"Investors aren't convinced they are worth it," he said.

By Charles Stein