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SPECIAL REPORT

## TOP-PERFORMING MANAGERS

# Continuity is watchword for equity, bonds

### EQUITY MANAGERS

REITs remain hot for year, accounting for half of top 10 strategies

By **ROB KOZLOWSKI**

**R**eal estate investment trusts continued to perform well for the second quarter in a row for the year ended March 31, accounting for five of the top 10 spots in Morningstar Inc.'s domestic equity separate account/collective investment trust database.

There was less of an overall dominance, however, than the fourth quarter, in which real estate securities and REITs accounted for eight of the top 10 overall domestic equity strategies in the year ended Dec. 31.

For the year, the remainder of the top 10 was a relatively even mix of traditional domestic equity strategies.

Nicholas Sundberg, data analyst — separate accounts at Morningstar Inc., Chicago, said there was no real dominant equity style for the year. He



Mitch Tobias

**BIG BOOST:** Adelante's Jeung S. Hyun said low interest rates are one reason for higher REIT returns.

said the mix of styles “probably relates more to the strength of the individual strategies than anything asset class-based.” The median return of domestic equity strategies in the Morningstar universe for the year

ended March 31 was 10.85%. The Russell 3000 index returned 12.37% in the same period.

Mazama Capital Management Inc. took both first and second places in the top 10.

Mazama's emerging manager small-cap growth strategy returned a gross 37.95% for the year, followed by the manager's small/midcap growth strategy with 31.65%.

Ron A. Sauer, founder, CEO and chief investment officer of Portland, Ore.-based Mazama, said both strategies benefited from the firm's experience as well as its familiarity with newer companies.

"Between us all we have over 120 years of experience following the big four (sectors), and all of us attend industry events to keep current on not only the companies that are doing the best today but the emerging companies in the industries that have new products, new services that their customers are really excited about," Mr. Sauer said.

"We have a lot of younger companies that a lot of managers don't follow that closely that ... are meaningful contributors to our portfolios," he added.

Regarding the emerging small-cap strategy, "what's really special about it ... the average weighted market-cap of that portfolio is \$1 billion and the average weight market cap of the Russell 2000 is over \$2 billion."

"We are taking the highest quality emerging small companies we can find in the country, much higher quality than a microcap portfolio, and we think it's the same quality or close to the Russell 2000 Growth, it's a great risk-reward proposition."

It is the second quarter in a row that the Mazama's emerging small-cap growth was the top-performing strategy and companies like specialty retailer **Zumiez Inc.** and technology company **Universal Display Corp.** greatly contributed to the strategy's success.

## Top-performing managers: SMA overall domestic equity

One-year return	Style	Gross return	Net return
Mazama Emerging Small-Cap Growth	U.S. SA small-cap growth	37.95%	36.68%
Mazama Small-Midcap Growth	U.S. SA midcap growth	31.65%	30.50%
PIMCO StocksPLUS Long Duration	U.S. SA large-cap value	29.36%	28.75%
<b>Adelante Total Return Fund</b>	<b>U.S. SA real estate</b>	<b>28.70%</b>	<b>27.39%</b>
Chilton Capital REIT	U.S. SA real estate	28.64%	27.61%
Mazama Select Growth	U.S. SA large-cap growth	28.12%	27.16%
Cornerstone U.S. REIT Total Return	U.S. SA real estate	27.75%	27.15%
PGI Real Estate Equity Securities	U.S. SA real estate	27.73%	27.04%
Wellington Real Estate Securities	U.S. SA real estate	27.35%	26.42%
RBC GAM Conc. Midcap Value Equity	U.S. SA midcap blend	27.34%	26.14%
Five-year return	Style	Gross return	Net return
Naylor Core	U.S. SA midcap growth	27.41%	24.74%
Chickasaw MLP SMA	U.S. SA energy limited partnership	26.86%	26.03%
PIMCO StocksPLUS Long Duration	U.S. SA large-cap value	25.71%	25.09%
Yorkville MLP Core Income Strategy	U.S. SA energy limited partnership	24.13%	21.62%
Allianz U.S. Ultra Micro Cap	U.S. SA small-cap growth	24.06%	22.78%
Cushing MLP Alpha Total Return Strategy	U.S. SA energy limited partnership	23.97%	23.10%
MAI Energy Infrastructure & MLP Strategy	U.S. SA energy limited partnership	23.80%	22.59%
Harvest MLP Alpha Strategy	U.S. SA energy limited partnership	23.75%	22.92%
NBW Capital MLP (Formerly Taylor MLP)	U.S. SA energy limited partnership	23.64%	22.60%
Analytic Small-Midcap Equity	U.S. SA small-cap value	23.22%	22.24%

Source Morningstar. Returns as of March 31, 2015.

Universal Display, which provides displays for some Apple Inc. products, also reflects Mazama's deep industry research, said Mr. Sauer. "The industry research we're doing is really paying off. ... (W)e do a lot of research on Apple and a lot of insights on their suppliers and partners, and some of these are really small companies," Mr. Sauer said. "It's very helpful to us."

Another Apple supplier, semiconductor company **Skyworks Solutions Inc.**, has been a great driver in the performance of the small-midcap growth strategy, Mr. Sauer said.

"Here's a company I've known for 20 years," Mr. Sauer said. "They had a monstrous last 12 months because they gained market share in the

iPhone 6 families."

"They've had over double earnings growth in two years and close to double revenues for two years in June, so their market cap during that period has gone from \$3.5 billion up to \$18 billion," Mr. Sauer said. "We've had this in the small portfolio till just recently and we had to graduate it out."

### PIMCO's StocksPLUS

Pacific Investment Management Co.'s StocksPLUS long-duration strategy ranked third, with a gross 29.36% return in the year ended March 31. The strategy combines S&P 500 derivatives with a portfolio of long-duration bonds.

"What we really wanted to do was create a vehicle for the corporate pension (fund that) wanted to main-

tain equity exposure but have their fixed-income exposure doing something closer to the liabilities,” said Steve A. Rodosky, Newport Beach, Calif.-based managing director and portfolio manager.

Much of the driver of the growth of the strategy is due to far better fixed-income performance in the past year than anticipated due to interest rates continuing to remain low.

Adelante Capital Management LLC’s Total Return Strategy ranked No. 4 overall for domestic equity separate accounts, with a gross return of 27.4%. The strategy only has real estate investment trusts in its portfolio or real estate securities with similar cash-flow characteristics, said Jeung S. Hyun, Oakland, Calif.-based principal and portfolio manager, in a telephone interview.

“We’re obviously trying to deliver at least 100 basis points net of fees to our clients in that strategy above our benchmark, which is the Dow Jones Wilshire REIT index,” Mr. Hyun said.

That index returned 25.2% in the year ended March 31. Mr. Hyun said the overall success of REITs in the past year is due in part to what he calls a “benign interest rate environment.”

“I think there’s a perception in the public that REITs are interest rate sensitive and — unlike what happened in 2013 when we went through a taper tantrum — I think there’s a perception that the rates are going to stay fairly benign in the foreseeable future.”

Mr. Hyun said the total return strategy itself benefited from Adelante’s size. The money manager has \$2.4 billion in assets under management, including \$1.5 billion in the strategy, which is on the smaller side of REIT managers. That size “has given us the flexibility to invest in some of the smaller REITs in the space where we find attractive value,”

Mr. Hyun said. “Take for example a company with a market cap of, say \$500 million. Some of the larger players in the space, their investment in the company is not going to be meaningful for their performance.”

One such holding is **CoreSite Realty Corp.**, which operates data centers across the U.S. “It’s one of the smaller names in the index,” Mr. Hyun said. “It’s less than half a percent of the index ... it was the second best-performing REIT in the space ... (and) we’re the sixth largest shareholder.”

Ranking fifth was Chilton Capital Management LLC’s real estate investment trust strategy, with a gross return of 28.64% in the year ended March 31.

Matt Werner, an analyst and REIT portfolio manager at Houston-based Chilton, said the drop in 10-year Treasury rates contributed to the overall performance of REITs, but also higher rents.

“There has been very little new supply,” Mr. Werner said. “When you’re currently with well-located properties, it gives you the ability to raise rents on your tenant and that has helped drive REIT valuations.”

Specific to Chilton’s strategy, the performance of two REITs that had recently been purchased, **AmREIT Inc.** and **Granite Real Estate Investment Trust**, contributed to its outperformance, and the self-storage and data center sectors also performed extremely well, Mr. Werner said.

Naylor & Co. Investments LLC, San Francisco, led the five-year composite rankings with its core composite strategy, which returned a gross aggregate 27.41% for the five years ended March 31.

The strategy has a focused portfolio of 35 to 45 stocks in four to six “recovering industries” ranging from micro-cap to large-cap companies. Morningstar categorizes the strategy

as midcap growth based on most holdings falling within that asset class.

The rest of the top five overall domestic equity strategies in the five years ended March 31 were: Chickasaw Capital Management LLC’s MLP strategy, with an aggregate gross return of 26.86%; PIMCO’s StocksPLUS strategy, at 25.71%; Yorkville Capital Management LLC’s MLP core income strategy, at 24.13%; and Allianz Global Investors’ U.S. ultra microcap strategy, at 24.13%.

The median five-year return among all domestic equity managers in the Morningstar universe was an aggregate 15.01%, above the Russell 3000’s 14.71% in the same period.

In the collective investment trust universe, the FMT/T. Rowe Price health sciences strategy led all domestic equity managers with a net return of 41.42% for the year ended March 31.

The rest of the top five CIT strategies for the year ended March 31 were: the J.P. Morgan Chase Bank U.S. real estate securities fund, with a one-year net return of 26.38%; the Wilmington Trust Fiduciary Services Co.’s total return REIT fund, 25.80%; American Century’s U.S. Real Estate Securities Trust, 25.46%; and State Street Global Advisors’ REIT index fund, 25.15%.

All of the data for *Pensions & Investments’* quarterly top-performing managers report are provided from Morningstar’s global separate account/collective investment trust database. For information on the database, please contact [separateaccounts@morningstar.com](mailto:separateaccounts@morningstar.com) or call 312-384-4087. ■

