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WINNERS' CIRCLE

## The Few Mutual-Fund Managers Who Avoided the Debacle

Only a handful of stock funds managed to scratch out a positive 12-month return during a bear market—while most succumbed to losses



The top mutual fund for the past 12 months, Federated Hermes Strategic Value Dividend Fund, was powered by its focus on dividends. EVA VAZQUEZ

BY SUZANNE MCGEE

The bear market of 2022 features some extraordinarily destructive claws, and few mutual-fund managers have managed to escape unscathed.

Of the 1,342 actively managed U.S.-stock funds tracked by The Wall Street Journal (using data from Morningstar Inc.), only 32 managed to end the rolling 12-month period in positive territory by the end of the second quarter.

The average performance for the fund managers was ugly. The funds recorded a total return of minus 15.2% for the 12 months—with the blame falling on the 2022 portion of that period, when the inflation-racked stock market posted its worst first half in decades. The funds fell a brutal 17.1% in that first half of 2022.

So, how did the handful of fund managers tracked by the Journal's Winners' Circle quarterly survey manage to post gains in this market?

The No. 1 finisher, and the only fund with a double-digit gain, was Federated Hermes Strategic Value Dividend Fund (SVAIX),



He's No. 1: Daniel Peris of Federated Hermes Strategic Value Dividend Fund, up 11.8% for the 12 months.

whose manager, Daniel Peris, ended the second quarter of 2022 in positive territory for both the rolling 12-month period—a gain of 11.8%—and the first six months of the year, at 4.9%. He took a different approach to outperformance than many of the winners of

the competition in past quarters have done.

"We're not trying to buy low and sell high," says Mr. Peris, voicing a philosophy that he acknowledges is at odds with many if not most of his peers. Instead, his strategy as a fund manager is to view what he does as buying and owning businesses, as a shareholder. More specifically, he wants to own stakes in businesses that pay out hefty dividends, have a record of raising those dividends regularly and have the ability to continue doing so.

### No time for heroes

"We deliver high and rising income streams to retirees or other conservative investors, and have been doing so since our inception in 2001," Mr. Peris says. It's not, he adds, a "heroic" strategy. "You won't read about us on the front pages," he says (though, of course, he now is in the lead story of this special report). On the other hand, the fund not only topped the Winners' Circle list, and ended the year-to-date period in the black, but offered a 4.53% dividend yield, well above index levels of 2.3%.

Dividends haven't been a major long-term contributor to investment outperformance in decades. Instead, portfolio managers—encouraged by work done by thinkers like Nobel laureates in economics Merton Miller and Franco Modigliani—have emphasized the importance of earnings growth in generating returns. Now, with inflation surging, interest rates rising and earnings growth expected to slow, most of the funds topping the Winners' Circle emphasize investments in stocks with high yields, or other characteristics that had left them on the sidelines of the now-defunct bull market.

"What we're seeing is a pretty major pivot," says Rob Arnott, founder and chairman of Research Affiliates, an investment-management firm. The change benefiting investors who concentrate on high-yielding investments rather than earnings growth can be traced not only to what he views as the market's extreme overvaluation of earnings, but also to the legacy of years of

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ultralow interest rates.

"We've had negative real interest rates [adjusted to reflect inflation] for about a decade, and free money like that causes an insidious form of damage to the market by creating a misallocation of resources," Mr. Arnott says.

#### How the survey works

In the quarterly Winners' Circle survey, the Journal identifies those managers who oversee actively managed U.S.-stock funds with more than \$50 million in assets and a record of at least three years. Not included are sector funds, leveraged funds or most quantitative funds. The list of those who have outperformed on a rolling 12-month basis isn't intended to represent a "buy list" for readers: Some funds may be closed, restricted to institutional investors, have high volatility, levy high fees, have limited liquidity or for other reasons be unsuitable for specific portfolios. The list of outperforming funds is designed to give readers an insight into the investment approaches that are having success within a specific time frame.

The fund managers who top this quarter's list all fall into the category of those who have combated the kind of capital misallocation identified by Mr. Arnott, and whose income strategies do well during market turmoil. One example: oil-and-gas companies like Exxon Mobil Corp., XOM 0.57%▲ which not only has struggled to obtain capital but until recently faced the headwind of depressed commodity prices. Now, the fundamental picture for the energy sector has made a 180-degree shift—and Exxon Mobil, like many of its peers, pays a hefty dividend.



No. 2: Michael Morey with Integrity Dividend Harvest Fund, up 9.1% for the 12 months.  
PHOTO: INTEGRITY VIKING FUNDS

That's one of the stocks in Mr. Peris's portfolio, and it also appears in the list of holdings for the second-place finisher in this quarter's survey, Integrity Dividend Harvest Fund (IDIVX), managed by Viking Fund Management in Minot, N.D. The fund recorded a 9.1% gain for the year ended June

30, although in the first half of 2022 it lost 2.5%.

"We've been actively adding to our energy holdings for more than a year," says Michael Morey, one of the portfolio managers on the team that manages the fund. Exxon Mobil appealed to them because of its 39-year (and counting) record of steadily boosting dividends, but also because Mr. Morey says it will benefit from the current supply/demand imbalance. "It's not just because of the Ukraine conflict," he adds.

But neither Mr. Peris nor Mr. Morey and his colleagues are simply chasing out-of-favor stocks. Rather, their emphasis on dividends and yield has led them to companies that appear disproportionately attractive to investors amid the mayhem of the bear market. Some holdings that the two funds both own include classic value names like tobacco giant Philip Morris International Inc. PM -0.77%▼ and telecommunications utility Verizon Communications Inc., VZ -0.10%▼ but names like Broadcom Inc. AVGO -0.17%▼ and Gilead Sciences Inc. GILD 0.51%▲ also make the cut.

Stay tuned for more surprising additions to the roster, Mr. Peris suggests.

"Our opportunity set has increased over the last year or two," he says. "We're now getting a look at [stocks] from sectors we couldn't have considered until recently. I think that will continue over the next decade."

Mr. Morey and his team agree. The only asset class they won't own, they say, is real estate. Everything else is fair game—as long as the dividend yield is solid. And as stock prices decline, pushing dividend yields higher, that's opening up new opportunities. "We're not afraid of deploying capital," says Trey Welstad, another member of the Integrity team.

John Kornitzer at No. 3 finisher Buffalo Flexible Income Fund (BUF BX) is another dividend-focused manager whose strategy has emerged into the spotlight. Based in Mission, Kan., Mr. Kornitzer vividly recalls the 1970s, when he managed money for General Electric, GE 0.92%▲ and says the market might be heading back into that kind of high-inflation/low-growth environment. And that thinking gives him even more confidence in his investment strategy, which emphasizes owning reasonably priced stocks of companies that have good balance sheets, offer attractive dividend yields and have solid if not spectacular prospects. For the rolling 12 months, Mr. Kornitzer's fund was ahead 7.5%, although it was down 2.7% for the 2022 first half.

#### Feeling 'back in vogue'

"What I do is back in vogue," Mr. Kornitzer says. "I've been through this before; I know that what I'm buying is right" and that his holdings will do well even if the market slides more. "No one can predict where a market will bottom," he says.

However, Mr. Kornitzer is casting a broader net than he might have done during market selloffs in the 1970s and 1980s.

True, he owns classic value stocks—pharmaceutical companies, energy giants, telecommunications utilities and consumer companies that meet core needs, like General

Mills Inc. GIS 0.46%▲ But one of the big contributors to his recent outperformance was Microsoft Corp., MSFT -0.42%▼ the kind of technology stock that he would have shunned in his early career. And he's now scouring the landscape, looking for companies that will benefit from what he expects will be a robotics/artificial-intelligence revolution. There are other companies on his "hit list" that offer dividends that would become attractive at slightly lower share prices.



No. 3 finisher: John Kornitzer of Buffalo Flexible Income Fund, up 7.5% for the 12 months.  
PHOTO: SHAUNA NEWTON

And most of the top performers in this quarter's survey have a lot more cash to deploy when they choose to do so, thanks to the fact that even single-digit gains over the last 12 months have been enough to attract steady inflows of new capital.

About 45% of the \$260 million in assets managed by Jeff Muhlenkamp in Muhlenkamp Fund (MUHLX), which finished at No. 5 in the survey, is still in cash. "That's my most important asset," says the portfolio manager, who posted a return of 5.6% for the rolling 12 months, and handily outperformed the broader market's first-half 2022 slump, limiting losses to 2.3%. "I have the option of waiting to go through the wreckage of the bear market in search of gems," he says. "When companies that meet my value and yield criteria get dumped, I'll be standing by," ready to buy.

How long will investors have to wait to hit that bottom? None of the winners is prepared to predict that, although most figure investors are heading into another periodic "shaking up" of the financial markets.

Whether it's the kind that investors witnessed when dot-com stocks imploded or subprime mortgage defaults brought the financial system to its knees, or something milder or even more serious, remains to be seen. Still, they're confident that the newfound affection for dividends and value investing isn't about to evaporate. Others may mourn the arrival of the bear market, but they're celebrating the new opportunities.

"This is the kind of market that makes contrarian investors feel like kids in a candy store," says Mr. Arnott.