21st Century champions

By David Snowball

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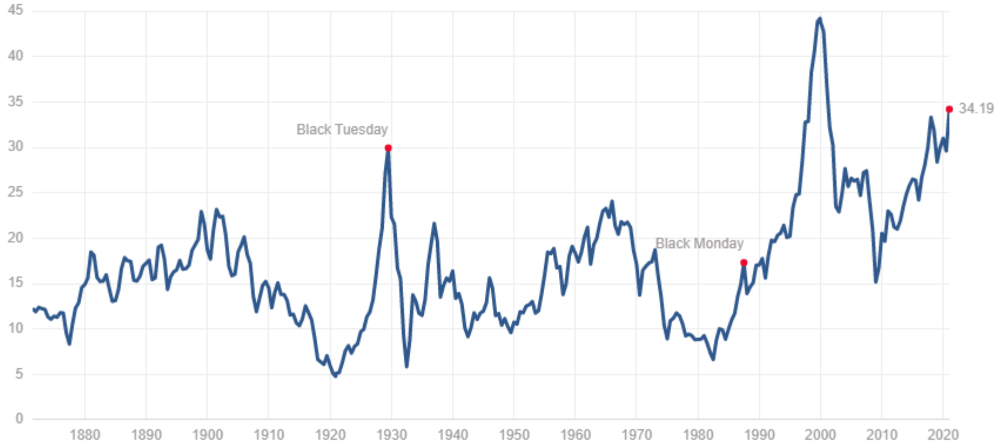
The second decade of the 21st century has just closed. The third decade promises turbulence in the near-term and disappointment in the longer term. A host of factors drives that pessimism. Interest rates are near-zero and likely to remain there, according to the chairman of the Fed, for years. That means that money market funds will return zero only if their sponsors waive all of their operating expenses. It also means that the long-term returns on US bonds may fall below zero because their advisers are not predisposed to offer their services for free. Investors, in response, are poured into equities and have done so using record amounts of borrowed money.

That's driven the price of US stocks to their second-highest level in 150 years, as measured by the Shiller PE Ratio. At 34.1 (as of 12/30/2020), it is more than double its historic average (16.8).



Over the long term, the returns you earn are conditioned by the price you pay: if you pay too much for your stocks, your long-term returns are going to be disappointing. State Street Global Advisors projects 6% long-term (10+ year) returns on equities, while BlackRock puts it at 5% and JPMorgan at 4%. And those are the professional optimists! We needn't even talk about the projections from GMO and those horrified by the consequences of more than a decade of financial manipulation by the Fed and others.

So, grownups say 4-6% for US equities over the next decade with high volatility and some risk of a severe price reset. Over the past decade, US growth investors have grown accustomed to 15-16% annual returns, while even much put-upon value investors have made double-digit gains. Translation: you might get slammed in the short-term and see your gains reduced by 50-75% in the long-term.

What to do?

Our recommendation: look for managers who have gotten it right, time after time.

To help identify such managers, we started with a list of 20-year, equity-oriented Great Owl funds. The Great Owl designation is earned by funds that have earned risk-adjusted returns in the top 20% of their peer groups for the past 3-, 5-, 10- and 20-year periods.

That's really hard. There are 2076 equity-oriented mutual funds with a record of 20 years or more. Only 52 of them—2.5%— are Great Owls. We refined the list by including only actively managed funds (42 of them, with most of the remainder being S&P 500 index funds) that are open to new investment (35 funds).

Using the screener at MFO Premium, we looked for ways to make the most relevant information comprehensible at a glance. We did that by identifying ratings that focus on returns (APR rating), risks (maximum drawdown, standard deviation, downside deviation, bear market performance, down market performance), and the risk-return balance (Sharpe rating). In our system, a blue box always represents a value in the top 20%, a green box is a value in the next 20%, yellow is the third tier, and so on.

The following table highlights the 12 best funds of the 21st century. The first six funds received perfect scores (7-for-7 top tier ratings), then four near-perfect funds (6-for-7), and two pretty durn perfect ones (5-for-7), with none receiving a score lower than green.

Name	Symbol	APR	APR vs Peer	APR Rating	MAXDD Rating	STDEV Rating	DSDEV Rating	Bear Rating	Down Rating	Sharpe Rating	AUM $M
AMG Yacktman Focused N	YAFFX	11.7	+5.0	5	1	1	1	1	1	5	3,419
AMG Yacktman I	YACKX	11.4	+4.7	5	1	1	1	1	1	5	7,289
Parnassus Core Equity Inv	PRBLX	10.4	+3.5	5	1	1	1	1	1	5	22,117
Saturna Amana Income Inv	AMANX	8.7	+1.8	5	1	1	1	1	1	5	1,428
Provident Trust Strategy	PROVX	8.0	+1.1	5	1	1	1	1	1	5	234
Jensen Quality Growth J	JENSX	8.0	+1.1	5	1	1	1	1	1	5	9,913
Janus Henderson Balanced T	JABAX	7.5	+1.8	5	1	2	1	2	2	5	23,732
John Hancock US Global Leaders Growth A	USGLX	8.3	+0.5	4	1	1	1	1	1	5	2,218
LKCM Equity Inst	LKEQX	7.9	+0.9	4	1	1	1	1	1	5	436
Madison Dividend Income Y	BHBFX	7.2	+0.4	4	1	1	1	1	1	5	301
Meridian Contrarian Legacy	MVALX	9.8	+1.2	5	1	1	1	4	4	5	587
Columbia Dividend Income Inst	GSFTX	8.7	+1.8	5	1	2	2	1	1	5	26,708

What does this mean?

Let's be clear: this is not a list of the funds with the highest 20-year raw returns. That list would be topped by **Lord Abbett Micro Cap Growth** (LMIYX, 14.4% APR), which is not a Great Owl, and **Wasatch Micro Cap** (WMICX, 14.3% APR), which is. The difference is driven by our concern for what risks investors were subjected to on the road to the fund's returns. Why? Two risks: (1) risks are sticky, and returns are not. High volatility strategies tend to remain high volatility across time, which can lead to ugly performance stretches. And (2) investors don't stick with high volatility strategies for long.

The Great Owl funds are ones whose returns outstrip their risks, not just once in a while but in every measurement period: three years and five years and ten years and 20 years.

What's up with these funds?

Yacktman and Yacktman Focused are almost freakishly successful, year and year, but almost every measure. They're sort of the (pre-2020) New England Patriots of investing. Adam Sabban at Morningstar characterizes them as "half equity fund, half absolute-return hedge fund," which favors great core businesses but is willing to hold cash, buy during panics and shop overseas. They've appeared in virtually every MFO essay on great risk-adjusted funds.

Disclosure

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Market prices of investments held by the Fund may fall rapidly or unpredictably due to a variety of economic or political factors, market conditions, disasters or public health issues, or in response to events that affect particular industries or companies.

A greater percentage of the Fund's holdings may be focused in a smaller number of securities which may place the Fund at greater risk than a more diversified fund.

Companies that are in similar businesses may be similarly affected by particular economic or market events; to the extent the Fund has substantial holdings within a particular sector, the risks associated with that sector increase.

The Fund invests in value stocks, which may perform differently from the market as a whole and may be undervalued by the market for a long period of time.

Investments in international securities are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic conditions, which could result in significant market fluctuations. These risks are magnified in emerging markets.

The Fund is subject to the risks associated with investments in debt securities, such as default risk and fluctuations in the perception of the debtor's ability to pay its creditors. Changing interest rates may adversely affect the value of an investment. An increase in interest rates typically causes the value of bonds and other fixed income securities to fall.

The Fund may invest in derivatives such as options and futures; the complexity and rapidly changing structure of derivatives markets may increase the possibility of market losses.

High-yield bonds (also known as "junk bonds") may be subject to greater levels of interest rate, credit, and liquidity risk than investments in higher rated securities. These securities are considered predominantly speculative with respect to the issuer's continuing ability to make principal and interest payments. The issuers of the Fund's holdings may be involved in bankruptcy proceedings, reorganizations, or financial restructurings, and are not as strong financially as higher-rated issuers.

The Fund may suffer significant losses on assets that it sells short. Unlike the possible loss on a security that is purchased, there is no limit on the amount of loss on an appreciating security that is sold short.

The Fund is subject to risks associated with investments in mid-capitalization companies such as greater price volatility, lower trading volume, and less liquidity than the stocks of larger, more established companies.

The Fund is subject to risks associated with investments in small-capitalization companies, such as erratic earnings patterns, competitive conditions, limited earnings history and a reliance on one or a limited number of products.

This article has been edited from its original version.

Definitions of terms in the table:

Annualized Percent Return (APR)

A fund's annualized average rate of total return each year over period evaluated. It is an abstract number, or so-called "geometric return," since actual annual returns can be well above or below the average, but annualizing greatly facilitates comparison of fund performance. APR is equivalent to CAGR, or compound annual rate of return. It reflects reinvestment of dividend and capital gain distributions, while deducting for fund expenses, fees, but excluding any load. The equation for APR can be found here. For Display (or evaluation) periods less than 12 months, MultiSearch does not annualize APR; in such cases, APR will stand for Absolute Percent Return.

The **APR Rating** represents quintile ranking of a fund's APR within category across specified evaluation period. It uses similar methodology as MFO Rating. An APR Rating of 5 represents "Best" in category.

The **APR vs Peer** represents Annualized Percent Return (APR) of a fund versus the average in its category across specified evaluation period. May be abbreviated as "AvP".

Maximum Drawdown (MAXDD)

The percentage of greatest reduction in fund value below its previous maximum over period evaluated. MAXDD can be the most frightening of a fund's many statistics, but surprisingly it is not widely published. Many top rated and renowned funds incurred maximum drawdowns of -60% or worse in 2009. The date (month/year) of MAXDD occurrence is also tabulated in the MFO rating system (Date MAXDD).

The **MAXDD Rating** represents quintile ranking of a fund's MAXDD within category across specified evaluation period. It uses similar methodology as MFO Rating, except in the case of MAXDD, "lower" is better. So, a MAXDD Rating of 1 represents "Best" in category. [Please note: Liberty is taken to use the absolute value of MAXDD (instead of its actual negative values) when assigning MAXDD Ratings so that lower is indeed better, like other risk ratings.]

Standard Deviation (STDEV)

A measure of fund volatility. The higher a fund's standard deviation, the more its return has varied over time. That can be both good and bad, since a rise or fall in value will cause standard deviation to increase. Typically, but not always, money market funds have lowest standard deviations, stocks funds have highest, while bond funds are in-between. In the MFO rating system, STDEV indicates the typical percentage variation above or below average return a fund has experienced in a year's time. On good or bad years, variations from average returns have been two or three times the standard deviation, and every now and then even more. The equation for STDEV can be found here.

The **STDEV Rating** represents quintile ranking of a fund's Standard Deviation (STDEV) within category across specified evaluation period. It uses similar methodology as MFO Rating, except in the case of STDEV, lower is better. So, a STDEV Rating of 1 represents "Best" in category.

Downside Deviation (DSDEV)

Another measure of fund volatility, but it measures only downward variation. Specifically, it measures a fund's return below the risk-free rate of return, which is the 90-day T-Bill rate (aka cash). Money market and very short-term bond funds typically have downside deviations very close to zero, since they normally return T-Bill rate or higher. Stock funds typically have the highest downside deviations, especially in bear markets. In the MFO rating system, DSDEV indicates the typical percentage decline below its average excess return a fund has experienced in a year's time.

The **DSDEV Rating** represents quintile ranking of a fund's Downside Deviation (DSDEV) within category across specified evaluation period. It uses similar methodology as MFO Rating, except in the case of DSDEV, lower is better. So, a DSDEV Rating of 1 represents "Best" in category.

Bear Market Deviation (BMDEV)

A fund's pure downside deviation during bear market months. Pure downside deviation includes only fund returns less than zero. Basically, BMDEV indicates the typical annualized percentage decline based only on a fund's performance during bear market months. The market being represented by S&P 500 index for equity funds and U.S. Aggregate Bond index for bond funds. Morningstar defines bear market months as follows: "a monthly drop below 3% for equity funds and a monthly drop below 1% for fixed income [bond] funds." MFO extends the definition to mixed asset and alternative funds using a 2.2% monthly drop threshold of the US6040 Balanced index, as well as applies the 3% equity drop threshold to commodity funds. BMDEV is used in the determination of Bear Market Rating.

The **Bear Market Rating ("Bear Rating")** represents decile ranking (1 to 10 where 1 is most bear market resistant fund) of funds of a given type (eg., equity, bond, mixed asset) based on bear market deviation (BMDEV). Starting in October 2019, this metric is relative to other funds of a given type; previously, it was relative to other funds in category. Bear market ratings are described further in Identifying Bear Market Resistant Funds During Good Times, as well as A More Robust Down-side Market Metric.

Down Market Deviation (DMDEV)

A fund's pure downside deviation during negative market months. Pure downside deviation includes only fund returns less than zero. Basically, DMDEV indicates the typical annualized percentage decline based only on a fund's performance during negative market months. The market being represented by S&P 500 index for equity and commodity funds, U.S. Aggregate Bond index for bond funds, and the US6040 Balanced index for mixed asset and alternative funds. This metric is a companion to Bear Market Deviation (BMDEV).

The **Down Market Rating ("Down Market")** represents decile ranking (1 to 10 where 1 is most down market resistant fund) of funds of a given type (eg., equity, bond, mixed asset) based on down market deviation (DMDEV). For more, see A More Robust Down-side Market Metric.

Sharpe Ratio

A measure of risk adjusted return, which is to say it helps quantify whether a fund is delivering returns commensurate with the risk it is taking. Specifically, it is the ratio of the fund's annualized excess return divided its standard deviation. A fund's "excess return" is any amount above risk-free investment, which is typically 90-day T-Bill. Sharpe is best used when comparing funds of same investment category over same evaluation period. The higher its Sharpe, the better a fund is performing relative to its risk, or more precisely, its volatility.

The **Sharpe Rating** represents quintile ranking of a fund's Sharpe Ratio within category across specified evaluation period. It uses similar methodology as MFO Rating. A Sharpe Rating of 5 represents "Best" in category.