

SPECIAL REPORT

TOP-PERFORMING MANAGERS

Growth equity strategies rocket ahead

Top 10 strategies see triple-digit returns, thanks to technology that benefited from the pandemic

By **ROB KOZLOWSKI**

Growth strategies already benefiting from technological innovation chalked up triple-digit returns as the COVID-19 pandemic accelerated change in the year ended Dec. 31, according to the latest data from Morningstar Inc.'s separate account/collective investment trust database.

Among the top 10 strategies, nine were growth strategies. Of those nine, four were large-cap strategies, three were small-cap and two were midcap, according to the data. One strategy fell within Morningstar's technology category, a sector that contributed to the success of many of the other strategies.

For the year ended Sept. 30, seven of the top 10 strategies were growth strategies.

Tony Thomas, senior manager research analyst for equity strategies at Morningstar Inc., Chicago, said in a telephone interview that the sectors that have dominated consistently even before 2020 have continued to do so.

"I think broadly speaking, the tech and tech-oriented, consumer cyclical, those are still generally the market leaders," Mr. Thomas said.

Every one of the top 10 domestic equity strategies posted triple-digit returns in 2020.

"When you think about what happened in 2020 with the pandemic, and it's a year that so many people want to forget for many reasons; who would have thought let alone in March, by midyear, 10 managers could post triple-digit returns in a single year?" Mr. Thomas said.

He also noted they were all fairly well-diversified portfolios.

"They've got more than five or 10 holdings, so they're doing well in a lot of different ways. They have a lot of things firing for them," Mr. Thomas said.

For the year ended Dec. 31, the median return for growth strategies was 32.63% in Morningstar's universe, while value strategies only returned a median 4.8%. The Russell 3000 Growth index returned 38.3% for the year ended Dec. 31, while the Russell 3000

Value index returned 2.9%.

The overall median return for domestic equities within the Morningstar separate account universe was 14.07% for the year, compared to the Russell 3000 index return of 20.9%.

Morgan Stanley on top

Morgan Stanley Investment Management had the first- and third-ranked domestic equity strategies for the year ended Dec. 31.

On top was the Morgan Stanley Inception strategy, which had a gross return of 166.36% for the period, and ranked third was the Morgan Stanley Discovery strategy, which had a gross return of 149.49%.

Inception is a small-cap growth strategy that "seeks high quality companies with sustainable competitive advantages and focuses on long-term growth potential rather than short-term events," according to its Morningstar profile. The strategy as of Sept. 30 had 35 holdings.

The top five holdings, which accounted for 30.2% of the portfolio, were **Overstock.com Inc.**, **Covetrus Inc.**, **Stitch Fix Inc.**, **Appian Corp.** and **NanoString Technologies Inc.**

The Discovery strategy, which ranked fourth last quarter, "has a fair amount of exposure to companies that have secular growth, like e-commerce, software-as-a-service (and) internet advertising," Dennis Lynch, head of Morgan Stanley Investment Management's counterpart global team, said in a November interview.

He noted **Zoom Video Communications Inc.** and **Shopify Inc.** as noteworthy drivers of outperformance at the time.

Mr. Lynch was not available to provide further information.

Ranked second for the year ended Dec. 31 was Zevenbergen Capital Investments LLC's Genea growth strategy with a gross return of 150.66%. It falls within Morningstar's technology category.

The strategy was also the top performer for the five years ended Dec. 31, with an annualized gross return of 41.93%.

Joseph Dennison, portfolio manager for the Seattle-based firm, said in a telephone interview that the Genea growth strategy "is a high-conviction, high-growth, all-cap equity strategy with a singular focus on building concentrated portfolios of companies that we believe are shaping the future."

These are companies with founding management teams in place to drive their companies into the next decade, he said.

The strategy in 2020 benefited greatly from investing early in companies that saw spectacular growth in the pandemic-affected environment.



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"A lot of those themes that we've been investing in in the last three to five years now saw incredibly strong and accelerating demand and growth," Mr. Dennison said. This included e-commerce, streaming companies, and companies in the realms of digital payments and digital health care.

The strategy's investment in **Tesla Inc.** was a significant driver of its outperformance.

"We have owned (Tesla) for over a decade now and really the overall thesis has been the same over the entire journey," Mr. Dennison said. "The future of transportation is electric."

Another driver was **The Trade Desk Inc.**, whose leadership in connected television advertising benefited from the ongoing shift in to streaming, Mr. Dennison said.

ARK comes in at No. 4

ARK Investment Management LLC ranked fourth for the year ended Dec. 31 with its Disruptive Innovation strategy, which returned a gross 131.93%.

Renato Leggi, client portfolio manager, said in a telephone interview that the disruptive innovation strategy is its flagship strategy.

"It's a kind of best ideas portfolio," Mr. Leggi said. "We think of it as the best way to gain broad exposure to innovation."

ARK centers its research on five innovation platforms: artificial intelligence, blockchain technology, DNA sequencing, energy storage and robotics. Within those platforms are 14 transformational individual technologies in which ARK invests.

Across its various strategies, ARK has 200 to 250 unique holdings, Mr. Leggi said.

"The disruptive innovation portfolio is really pulling kind of the best 35 to 55 stocks," he said, "and the weightings are driven from the bottom up, so we don't specifically target technology exposures in that fund, it's like where the value is taking us."

The top performing holdings in the strategy were **CRISPR Therapeutics AG, Invitae Corp., Roku Inc., Square Inc.** and Tesla Inc.

Ranked fifth for the year was Baillie Gifford & Co.'s U.S. equity growth strategy, which had a gross return of 129.49%.

Kirsty Gibson, Edinburgh-based investment manager for Baillie Gifford, said in a telephone interview the strategy's overall aim is to harness the asymmetry of returns in the U.S. stock market.

It considers the total wealth creation of the U.S. stock market over the last 19 years, she said, noting that while 25,000 firms collectively netted excess wealth of \$35 trillion, about 0.4% of those companies accounted for half of that excess wealth.

"We focus all of our attention on finding the companies that have the potential to be in that 0.4%," Ms. Gibson said. "We look for companies with vast market opportunities, headroom to grow unimpeded for long period of time even after periods of supernormal growth, and strong competitive opportunities that get stronger as they scale," she said.

Among the strongest performers in the strategy were **Moderna Inc.** and **The Trade Desk Inc.** "I think how we benefited in the last year is the pandemic accelerating structural change, and by that, I mean changes to the status quo," Ms. Gibson said.

'Growth had a very good year'

Granahan Investment Management Inc., Waltham, Mass., ranked sixth and seventh with its Small Cap Select and SMID Select strategies posting gross returns of 128.59% and 126.27%, respectively, for the year ended Dec. 31.

"We're bottom-up investors and we're bottom-up growth and long-only growth investors, so obviously growth had a very good

year," David Rose, chief investment officer and portfolio manager, said in a telephone interview.

"The primary driver of how we're trying to generate alpha at this shop is through our stock selection," Mr. Rose said. "Both of these portfolios are high-conviction portfolios where the top 10 names are, I believe for most of the year, were above 50% of the portfolio."

"We have about 50 names but the top 15 positions really drive the performance of the strategy in a given year."

The biggest contributors to both strategies' outperformance were **Digital Turbine Inc., Enphase Energy Inc.** and **Magnite Inc.**

"We bought these companies when they were all under \$500 million market caps," Mr. Rose said. "They've been huge long-term winners in the strategy and last year was really, I think, a big year for all three of them getting much broader investor interest."

In Enphase Energy's case, he specified, it's a solar company that has seen a whole new market opportunity open up in solar storage.

For the five years ended Dec. 31, nine of the top 10 strategies were all growth strategies.

Following Zevenbergen's Genea growth strategy, which falls within Morningstar's technology category, the rest of the top five were Granahan Investment Management's small cap focused growth strategy, which had an annualized gross return of 41%; Taylor Frigon Capital Management LLC's Israeli innovation strategy, 39.85%; Next Century Growth Investors LLC's microcap growth strategy, 38.87%; and Grahahan's Small Cap Select strategy, 38.6%.

The median five-year annualized return for domestic growth strategies in Morningstar's domestic equity separate account universe was 18.05%, and the median among all domestic equity strategies was 12.89%. The Russell 3000 Growth index returned an annualized 20.6% for the five years ended Dec. 31, and the Russell 3000 index returned an annualized 15.4%.

More growth in CITs

Within the collective investment trust universe, all of the top 10 domestic equity CITs for the one year and five years ended Dec. 31 were growth strategies.

The BNY Mellon U.S. small/midcap growth equity CIT led all trusts for the second quarter in a row with a net return of 69.3% for the year ended Dec. 31.

The rest of the top five CITs for the year ended Dec. 31 were: Jackson Square Partners LLC's smidcap growth CIT founders class, which returned a net 65.58%; Jackson Square Partners LLC's smidcap growth CIT A class, which also returned a net 65.58%; Hood River Capital Management LLC's small/mid cap growth CIT founder's class, 60.8%; and Artisan Partners' mid cap growth trust Tier 1, 59.23%.

The median return of domestic equity collective investment trusts in Morningstar's universe for the year ended Dec. 31 was 18.48%.

For the five years ended Dec. 31, %T. Rowe Price's New Horizons Class Z CIT led all trusts with an annualized net return of 27.08%, followed by the BNY Mellon U.S. small/midcap growth equity CIT, with a net 26.74%.

The rest of the top five CITs for the five years ended Dec. 31 were: T. Rowe Price's New Horizons Class D CIT, with an annualized net 26.27%; T. Rowe Price's New Horizons Class A CIT, 26.26%; and SS-GA's Nasdaq 100 Index Class A CIT 24.27%.

For the five years ended Dec. 31, the median annualized return for domestic equity CITs was 14.32%.

All data for *Pensions & Investments'* top-performing managers report are provided from Morningstar's global separate account/collective investment trust database. The data for the rankings on which this story is based were pulled Feb. 3. ■