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The Best Stock-Fund Managers of 2019

Needham Small Cap Growth, Baron Partners and Meridian Enhanced Equity Legacy were the top-performing actively managed U.S. stock funds in the latest Winners' Circle rankings

By Suzanne McGee

Many stock-fund managers are looking like stars based on last year's strong market. But there are new faces on the winners' podium.

The stock market's recovery from the lows recorded in late 2018, together with volatility during 2019, resulted in a shake-up in The Wall Street Journal's list of the best-performing actively managed U.S.-stock mutual funds for the trailing 12 months.

Some managers who have dominated our Winners' Circle rankings in recent quarters have vanished from the list of the dozen or so top performers, while others have yielded pride of place to a new crop of outperformers. Of the top 10 actively managed U.S. equity funds (as measured by those that have a record of at least three years, assets of at least $50 million, and that don't employ leverage or rely on quantitative screens), only one was featured previously in this quarterly column during 2019.

In a year in which the S&P 500 index generated a return of 31.5%, including dividend income, the fourth-quarter winners managed to do even better, thanks in part to a period that kicked off with a recovery from a market slump in the fourth quarter of 2018. Outperformers benefited from the volatility that underlaid last year's blockbuster index returns, as well as the fact that many of them allocated a significant chunk of their assets to a handful of individual stocks.

Consider Needham Small Cap Growth Fund (NESGX), which won our competition with a 54.5% gain, handily trouncing its nearest rivals.

"Our top 10 holdings tend to make up as much as 50% of our assets under management," says Chris Retzler, who has managed the fund since January 2008. Its single largest position as of the end of September (the latest period for which data was available at the time of writing) was a nearly 10% stake in Photronics Inc., one of a handful of smaller semiconductor-equipment manufacturers that Mr. Retzler has steadily increased exposure to over the past two to three years.

"We think that there could be a recovery in memory markets as 5G devices arrive on the market, and that would extend the current cycle" for testing and other equipment, says Mr. Retzler, who has allocated as much as 70% of the fund's assets to an array of smaller-cap technology companies.

He's No. 1: Chris Retzler led Needham Small Cap Growth to a 54.5% gain.

While Photronics wrapped up 2019 with a gain of 61%, it had a roller-coaster ride on the way to those gains, enduring a 30% selloff during the spring.

"Part of our emphasis is being able to manage [the fund] appropriately during market downturns," says Mr. Retzler. When it comes to semiconductor-equipment stocks in particular, "you have to have a feeling for the cycles, and to be flexible and nimble in trading." That, he adds, includes the ability to deploy cash strategically, buying whenever otherwise-appealing portfolio companies suffer blows to share prices and valuations caused by factors ranging from tax-loss selling at the end of a fiscal quarter to shifts in market psychology or a slump in liquidity.

Many of the stocks that led the Needham fund to emerge as the best-performing U.S. equity fund of 2019 experienced similar volatility. Shares of Cohu Inc., another semiconductor company among the five largest holdings in Mr. Retzler's portfolio, tumbled 30% in the fourth quarter of 2018. The shares bounced back, only to endure a 26% plunge last summer before wrapping up 2019 with a hefty 47.6% gain.

Indeed, the combination of a broad market slump in the fourth quarter of 2018 and a rally in the S&P 500 index of nearly 12% in the fourth quarter of 2019 had a big impact not only on the broad market but on which mutual funds outperformed during the calendar year.

If you look at the 15 months ended Dec. 31, 2019, rather than the rolling 12 months, that 31% surge in the S&P 500 becomes a mere 13.7%, since it incorporates the 2018 fourth-quarter selloff. Similarly, many of Mr. Retzler's outperformers benefited from comparisons to depressed valuations at the end of 2018. For instance, Aspen Aerogels gained 264% during the 2019 calendar year, but is ahead 67% from the end of the third quarter of 2018.

That pattern was particularly significant for those fund managers battling to cross the 2019 finish line in second, third or fourth position. Right up until the last days of the year, the outcome was in doubt, and it turned out to be how holdings performed in December that made a difference. Baron Partners Fund (BPTRX), which posted a 5.4% gain in the final four weeks of the year, ended the year with a 44.99% gain, beating third-ranked Meridian Enhanced Equity Legacy Fund (MEIFX) by a whisker. The Meridian fund, managed by Denver-based Arrowmark Partners, had a December advance of nearly 1.7%, finishing the year up 44.97%. Meanwhile, an anemic December advance of 0.6% put Tocqueville Opportunity Fund (TOPPX) at a disadvantage, and caused it to come in fourth in our ranking, with a gain of 44.8%.

This pattern is a reminder that The Wall Street Journal's list of outperforming funds is only a snapshot of what fared well during a certain 12-month period rather than a "recommended" list of funds likely to outperform over longer time frames. Often, managers are reaping the fruits of investments made several years ago, and have endured periods of underperformance en route to their moment in the spotlight.

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"We focus on companies that we think will grow a lot over the long term, and as a result have turnover of less than 10% a year," says Ron Baron, founder of New York-based Baron Capital and manager of Baron Partners Fund.

Mr. Baron, who began his investing career in 1969, first invested in Vail Resorts Inc., a property management and development company with ski resorts in three countries, in 1997. It gained nearly 15% during 2019, and 172% over the past five years. Mr. Baron figures that's simply the start of even greater returns, and classifies the company as a stable grower that he expects to double in price over the next five to 10 years.

The Baron Partners fund also has big positions in more companies with more volatile returns that Mr. Baron describes as "disruptive."

"They are changing the entire paradigm" in their industries, he says, citing electric-car maker Tesla Inc. as a case in point. An investor since 2014, Mr. Baron says revenues have soared eightfold during that period, and he believes the company is on track to ultimately deliver $1 trillion (yes, trillion) in sales. "It's very volatile," he acknowledges, but points out that Tesla's stock soared 132% from its lows in early June 2019, and that shares wrapped up the calendar year with a gain of about 35%.

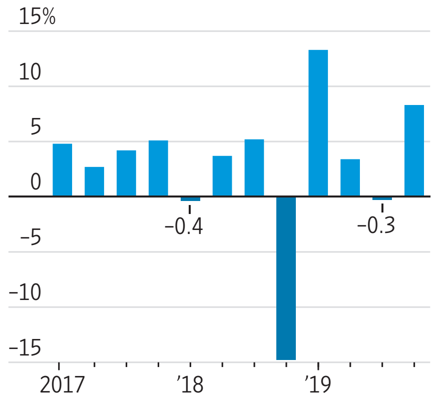
"We view the stock price as irrelevant as long as a company is progressing in the way we hope and expect it will," Mr. Baron adds. "We want to invest in companies at the time they are investing in themselves" and notes he doesn't mind waiting years for investments in "disruptive" companies like Tesla or real-estate venture Zillow Group to pay off.

While Mr. Baron—like most of our other outperforming mutual-fund managers in the recent past—concentrates his fund's assets in a relatively small number of holdings, he tries to offset riskier and more volatile holdings by putting money into more-established companies, like Hyatt Hotels or Charles Schwab. He has watched the latter's share price soar and then retreat since the financial firm announced a $26 billion deal to acquire former rival TD Ameritrade in late November, but he isn't worried.

"It's all about the aggregation of assets," he says, adding that he expects Schwab will emerge as the asset-management industry's dominant player. Moreover, he argues, his long-term strategy means that more of his fund's holdings beat the market over the longer haul, making its higher fees (an expense ratio of 2.03%) acceptable to his investor base.

Score at the Quarter

U.S.-stock funds were up average 8.3% for the fourth quarter, completing a 28% full-year gain. Average total return, U.S. diversified funds.



Source: Lipper

One of the youngest and newest outperforming fund managers is 34-year-old Paul Lambert, who took the helm of Tocqueville Opportunity Fund in November, after spending eight years working alongside its previous manager, Thomas Vandeventer. "Nothing much has changed" in the investing approach, Mr. Lambert says, although he has spent the first few months of his tenure trimming the fund's holdings from about 220 to some 100 of its best ideas.

The logic behind that move is simple, he says. "If a name in which we have only 0.1% of our assets invested triples, it won't make a huge difference to performance," he explains. "If I can focus our attention on fewer names, it will provide us with a deeper understanding of that business," as well as more upside potential should those companies outperform.

Among the companies that contributed to 2019 outperformance and that Mr. Lambert is emphasizing going forward is Shopify, which accounts for 7% of the fund's $88 million in assets under management. The fund first added the e-commerce platform management company to its portfolio when Shopify's stock was changing hands for $30 or so; today its share price hovers around $407, up nearly 200% since the beginning of 2019.

"Shopify is helping to incubate at least a million small merchants, providing them with everything from websites and payment solutions to inventory management," Mr. Lambert says.

Other internet-related businesses catering to smaller to midsize enterprises that he finds alluring include those that offer cloud-based human-resources services, including payroll and benefits management. Ventures like Paylocity (up 102% in 2019) and Paycom Software (up 127%) can boast annual revenue growth of as much as 30%, as well as high customer-retention rates. "It's kind of a pain to change your payroll manager," Mr. Lambert says, explaining why these are among the companies to which he is allocating more assets.

As with all of this quarter's winners, each of whom has benefited from the continuing rally in the technology arena, Mr. Lambert isn't worried about a bubble that might suddenly burst. "A lot of technology companies are being painted with a broad brush as being overvalued, but overall I think we're still in the fifth or sixth inning of this game," he says.

Ms. McGee is a writer in New England.