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WINNERS' CIRCLE

And the No. 1 Stock-Fund Manager Is...

Dennis Lynch, manager of Morgan Stanley Institutional Discovery Portfolio, tops the list in our quarterly contest's results

By Suzanne McGee

Boring can be beautiful. In fact, in the midst of volatile markets, being downright dull can prove the recipe for investment.

That's what The Wall Street Journal's latest quarterly survey of actively managed U.S.-stock funds suggests. Managers on our list of Winners' Circle finalists remain upbeat and unflappable. Many posted returns of more than double the S&P 500 index for the 12 months ended June 30, a period in which that index gained slightly less than 10%.

Their secret, they argue, is underweighting or ignoring household names (Apple , Google parent Alphabet , Facebook , etc.) that have been common holdings for many of our past winners in favor of lesser-known businesses able to demonstrate consistently robust gains in earnings and share prices.

"Most of the funds that have made your list in the past may be more glamorous or volatile than we are, and they also may own more speculative or volatile stocks" whose performance is driven by momentum, says Stephen Grant, manager of Value Line Mid Cap Focused Fund (VLIFX), who wrapped up the 12-month period with a gain of 26.9%. That puts him in second place in this quarter's Winners' Circle competition, which seeks to identify those broadly based U.S. equity funds (no global funds, sector funds, quantitative funds or leveraged funds qualify) with at least $50 million in assets and a three-year record that have outperformed their peers.

The winner: Dennis Lynch, head of the Counterpoint Global team at Morgan Stanley Investment Management and manager of Morgan Stanley Institutional Discovery Portfolio (MPEGX)—which romped across the finish line with a 30.8% return for the trailing 12 months ended June 30.

In our Winners' Circle survey of stock-manager performance, Dennis Lynch wins with a 30.8% gain for the past 12 months in his Morgan Stanley Institutional Discovery Portfolio. PHOTO: MORGAN STANLEY

Lower profiles

This quarter's winners' list is dominated by fund managers who emphasize stocks you may never have heard of but might want to get to know, as managers believe these are the companies and stocks that will keep churning out solid returns in bull markets, and protect investors from participating in any future selloff. "These are boring stocks to the casual observer, but to their management, their businesses are very exciting, and certainly the returns are great," says Mr. Grant. "Owning them won't make us the top performer in a bull market, but it will ensure we deliver smooth and consistent gains over the long term."

In some cases, the shift to less-high-profile stocks has been the result of a deliberate change in strategy. Mr. Lynch, for example, says he is reaping the fruits of a decision to de-emphasize both big tech companies and businesses that have exposure to the Chinese economy. "Historically, we had some exposure in these areas, but in the last few years, we've tried to shift away from that and identify opportunities in smaller and midsize companies," says Mr. Lynch, who also oversees the fourth-ranked Morgan Stanley Insight Fund (CPODX), which wrapped up the same period with a 12-month return of 26.5%.

Instead of focusing only on a company like Amazon.com , Mr. Lynch says, both of those funds have a stake in a firm that he describes as an "alternative" to the e-commerce behemoth. Shopify Inc., based in Ottawa, provides its customers with the platform and tools to develop an online shopping presence.

"They have benefited from offering a robust suite of solutions to their small and medium sized customers and by continuously developing services that reduce their customers' friction costs," Mr. Lynch says, adding that he expects that as its customer base grows, Shopify also will be able to increase the array of services clients use. Shopify's stock soared 106% in the 12 months ended June 30, making it a major contributor to the returns posted by both Morgan Stanley funds.

Similarly, while many investors may continue to identify Oracle as the epitome of a database provider to corporations, Mr. Lynch would rather own MongoDB Inc. While MongoDB may be off the market's radar, its nonrelational-database-management software is the product of choice for people who make corporate purchasing decisions—in-house IT developers. It "is becoming more interesting due to the fact that it's now developers who are driving adoption and purchase decisions."

And when it comes to the health-care arena, Mr. Lynch again is willing to follow the road less taken. Forget about pharma-

(over please)

ceutical companies: One of his favorite businesses is Covetrus Inc., an animal-health company spun off by Henry Schein Inc. and merged with Vets First Choice early this year. So far, the stock hasn't kept pace with some of his other choices, but that's a matter of time, he calculates. The stock is "misunderstood, because it was a complex spinoff from Henry Schein and a merger" with a privately owned company, he says. Given the willingness of American families to spend on their pets, Mr. Lynch says, "the animal health industry is showing good steady growth."

This quarter's winners shun flash and pizzazz as being too risky and volatile.

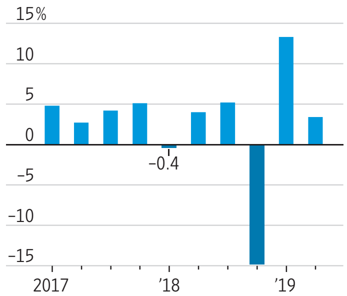
"Would you rather have been one of those Gold Rush miners praying to strike gold, or the person who chose to sell picks and pans to the miners?" asks Value Line's Mr. Grant. That's why he seeks out the contemporary equivalent of those merchants or the clothing businesses that marketed hard-wearing blue-jeans to the 19th-century miners. "It's not what you make in bull markets, it's what you keep" when those markets wobble, he says. Then investors don't have to play catch-up.

Today's equivalents to those California entrepreneurs flogging gold-mining tools include companies that Mr. Grant believes are least vulnerable to economic headwinds and that have a history of smooth returns.

One of his favorite holdings is Heico Corp. , which sells highly engineered products and services to companies in defense and aerospace. Its shares rose 83.7% in the 12 months ended June 30, even as Mr. Grant notes that the average industrial in the S&P 500 was up

Score at the Quarter

U.S.-stock funds in the second quarter cooled down from the first quarter's rally, but still added 3.4% (average total return, U.S. diversified funds).



Source: Lipper

11% and the average industrial in his fund's portfolio jumped 34%.

Clearly, it's important for a manager to pick the right stocks—but this quarter's winners agree that what they avoid is just as significant.

Selective at Eaton Vance

Virtually all of them run relatively concentrated portfolios, with 25 to 50 holdings. Currently, Mr. Grant's fund has 40 stocks, and even that limited list of holdings makes it more diverse than our No. 3 fund in the contest, Eaton Vance Atlanta Capital Focused Growth Fund (EILGX). The latter seldom owns more than 30 individual companies and currently has only about 25 positions—but still managed to post a gain of 26.7% in the 12 months ended June 30.

Joe Hudepohl, who has managed the Eaton Vance fund for the past four years, is content owning only two dozen or so companies in the $71.2 million portfolio. He says he demands candidates demonstrate a 10-year operating history as a public company as well as the same kind of smooth and steady increase in earnings that Mr. Grant looks for.

"Seeking out quality tends to provide great downside protection for our investors," he says. "We participate in up markets, and we protect capital when things are more difficult."

Mr. Hudepohl's fund is a new arrival at the top of the Winners' Circle rankings, but he isn't surprised. The kind of high-quality stocks Mr. Hudepohl looks for "have been largely out of favor since 2009 or 2010, until the last 12 or 18 months," he says. "In the ultralow-interest-rate environment, people will take on more risk, and that has paid off for them. We had a frustrating few years." Until, that is, the market became more anxious about the outlook for both interest rates and earnings growth late last year, propelling the stock prices of several of Mr. Hudepohl's steady growers.

Like Messrs. Grant and Lynch, he favors lesser-known businesses that can deliver steady profits rather than betting that volatile household names will, in fact, deliver big splashy gains or on unproven companies that have just gone public. "These are businesses we tend not to be involved in."

Instead of owning biotech companies, for instance, he likes Danaher Corp. (up 44.8% in the 12 months ended June 30) and Thermo Fisher Scientific (up 42.8%). Neither company's fate is tied to the success of a single research breakthrough. Both make "everything that you can think of that is used in research and development to make drugs, do research and develop industrial applications," Mr. Hudepohl says. Regardless of who wins the biotech wars, both firms will profit from selling those companies the equipment required to sustain R&D. The icing on the cake: Both companies are also good at acquisitions, he says, and devote some of their ample free cash flow to stock buybacks.

Mr. Hudepohl likes Dollar General (up 36.3%), which he describes as one of the few retailers he expects to survive and thrive in a cutthroat environment. The discount dollar store—with a strong base in rural areas abandoned by some of its competitors, Mr. Hudepohl says—has posted strong growth in the square footage of its stores and in same-store sales.

All about control

For these top-performing managers, it's all about control. They acknowledge there's no way to manage or predict big trends—from trade spats or retail-sales growth to interest-rate decisions by Federal Reserve policy makers. "All you can do is find the stuff you can predict, like earnings and individual business trends, and own that," Mr. Hudepohl says.

Readers may also draw some lessons from this approach. While these outperforming funds have done well over the past 12 months, most of their managers have endured longer periods during which they were laggards and only now are reaping the benefits of investment decisions made three or more years ago. "Our goal is outperformance over a full market cycle, not just the short term," says Mr. Hudepohl. "The short term isn't what we're about."

Ms. McGee is a writer in New England.

IMPORTANT INFORMATION

1. Source: Wall Street Journal as of June 30, 2019. In the quarterly Winners' Circle contest, the WSJ identifies the most successful actively managed U.S.-stock funds for the previous 12 months, based on Morningstar Inc. data. Only mutual funds with at least $50 million in assets and a track record of at least three years qualify; no index, sector or leveraged funds are included.

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Morgan Stanley Institutional Fund Discovery Portfolio (MPEGX)

Top Ten Holdings (% of Total Net Assets)	**Fund**	**Index**
Veeva Systems Inc	8.02	0.63
MongoDB Inc	6.56	--
Coupa Software Inc	5.53	--
Shopify Inc.	5.46	--
Twitter Inc	4.64	0.85
Twilio Inc	4.53	0.38
Spotify Technology S.A.	4.29	--
Smartsheet Inc	3.85	--
Okta Inc	3.68	0.32
Wayfair Inc - Class A	3.35	0.27

Sector Allocation (% of Total Net Assets)	**Fund**	**Index**
Information Technology	43.87	33.20
Health Care	25.07	14.42
Communication Services	14.02	3.76
Consumer Discretionary	11.59	16.12
Financials	1.01	6.44
Cash	4.40	--

As of June 30, 2019. Subject to change daily and are provided for informational purposes only and should not be deemed as a recommendation to buy or sell the securities shown or securities within sectors shown above.

Average Annual Total Returns as of June 30, 2019 – Class I Shares	**1 Year**	**3 Years**	**5 Years**	**10 Years**	**Since Inception (3/30/1990)**
MPEGX	30.68	27.81	12.94	16.02	13.11
Russell 3000 Growth Index (%)	13.94	16.49	11.10	16.02	10.72

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Morgan Stanley Insight Fund (CPODX)

Top Ten Holdings (% of Total Net Assets)	Fund	Index
Amazon.com, Inc.	5.77	5.20
Illumina, Inc.	5.02	0.36
Intuitive Surgical, Inc.	4.83	0.40
Coupa Software, Inc.	4.64	0.05
Mongodb, Inc.	4.59	--
Veeva Systems, Inc.	4.54	0.13
Shopify, Inc.	4.52	--
Twilio, Inc.	4.47	0.09
Spotify Technology S.A.	4.46	--
Twitter, Inc.	4.00	0.17

Sector Allocation (% of Total Net Assets)	Fund	Index
Information Technology	38.40	31.96
Health Care	30.84	14.17
Consumer Discretionary	13.20	15.04
Communication Services	11.73	11.42
Cash	5.65	--

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Average Annual Total Returns as of June 30, 2019 – Class I Shares	1 Year	3 Years	5 Years	10 Years	Since Inception (7/28/1997)
CPODX	26.12	32.32	19.81	20.47	11.10
Russell Midcap Growth Index (%)	10.60	17.81	13.02	16.13	7.16

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Where the net expense ratio is lower than the gross expense ratio, certain fees have been waived and/or expenses reimbursed. These waivers and/or reimbursements will continue for at least one year from the date of the applicable fund's current prospectus (unless otherwise noted in the applicable prospectus) or until such time as the fund's Board of Directors acts to discontinue all or a portion of such waivers and/or reimbursements. Absent such waivers and/or reimbursements, returns would have been lower. Expenses are based on the fund's current prospectus.

Performance and fund information is as of June 30, 2019, unless otherwise noted. Returns are net of fees and assume the reinvestment of all dividends and income. Returns for less than one year are cumulative (not annualized). Performance of other share classes will vary. Please keep in mind that double-digit returns are highly unusual and cannot be sustained. Investors should also be aware that these returns were primarily achieved during favorable market conditions.

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