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Technology

How a $33 Billion Fund Manager Scored a Perfect Record Betting on Value

- Hotchkis & Wiley's win rate is best among large fund families
- Passive, momentum-driven market creates opportunities: McBride

by Lu Wang
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To those who argue that value investing has gotten too hard in today's momentum-chasing, passive-driven world, Scott McBride's results are a bit of a conundrum.

His firm, Hotchkis & Wiley Capital Management in Los Angeles, just hit the investment perfecta in terms of stock-picking acumen. All 10 of its actively managed mutual funds – from US large-cap stocks to high-yield bonds and international small-cap equities – beat their benchmarks in the three and five years through August.

The red-hot run for the 44-year-old shop is a rare rebuttal to conventional wisdom saying active management has lost its edge when passive funds regularly trample anyone trying to beat them. It's also a measure of vindication for value investing itself, a strategy long overshadowed by growth funds and their market-beating gains. Several of Hotchkis & Wiley's funds beat broader equity indexes – not just those tuned to cheapness – for long stretches of the period.

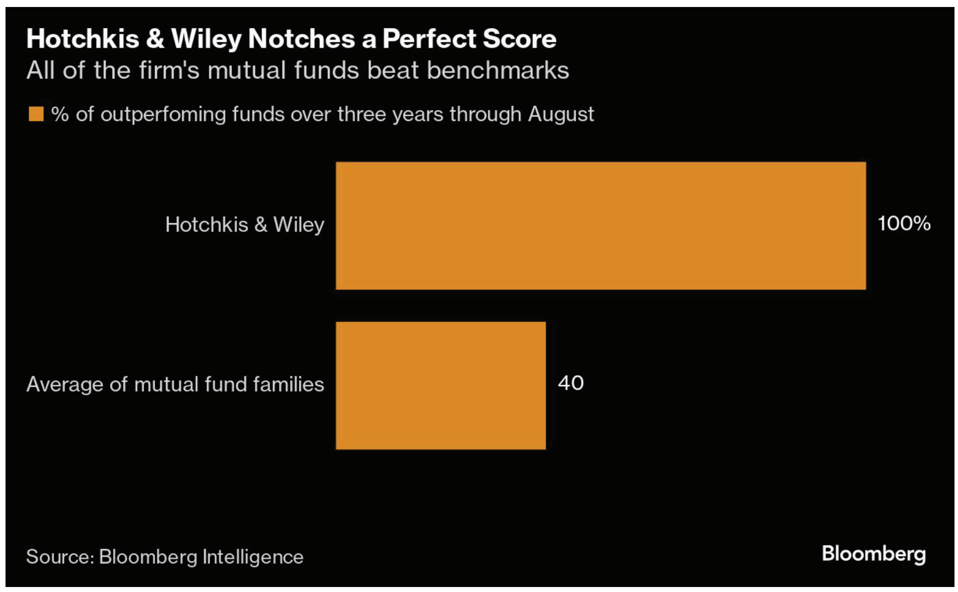
To McBride, the chief executive, it's the very trends said to doom the value style – relentless passive flows into growth names, fickle investor tastes – that create exploitable inefficiencies and let stock pickers shine. Even with the S&P 500's price-earnings ratio approaching all-time highs, he says it's still possible to build portfolios with multiples in line with the historic average – and find winners among them.

"The market is driven by sentiment, it's driven by emotion," said McBride, whose firms oversees $33 billion in assets. "When you don't have a lot of folks who are thinking about what long-term value is, that creates opportunity."

Hotchkis & Wiley's 100% win rate is the highest among 91 large firms with 10 or more mutual funds and well ahead of the group's average of 40%, according to data compiled by Bloomberg Intelligence's mutual fund analyst David Cohne.

The results land amid a raging debate about the viability of value investing. Venerable managers have decried a market overrun by price-insensitive products such as index and exchange-traded funds, leaving no natural buyer to lift the laggards and close a valuation gap between cheap and expensive stocks that is among the widest in history.

McBride's success is proof that those trends don't doom stock pickers – that outsized returns can still be located. Certain data bears it out. An earlier study by Bloomberg Intelligence equity strategist Chris Cain found that among the cheapest fifth of the Russell 3000 Index, the proportion of stocks whose return topped the broader market rose to a five-year high of 54% in 2021 and stayed there the following year.



On the whole, though, value stocks have struggled to keep up with the market. An index of stocks ranked low in metrics such as price to earnings or book value sank to a record low in July relative to the Russell 3000, thanks to a profit boom around the artificial-intelligence craze.

Several Hotchkis & Wiley funds bucked the trend. The $675 million Value Opportunities portfolio (HWAAX) returned 10% annually in the three years to Aug. 30, outpacing the Russell 3000. Also ahead were funds focused on small-caps (HWSIX) and mid-caps (HWMIX).

Hotchkis & Wiley seeks to uncover companies whose fair values based on three-to-five-year projected growth are meaningfully below their market prices and that preferably pay dividends or buy back shares.

The path isn't always smooth. This year, for instance, the majority of Hotchkis & Wiley's funds are underperforming. McBride isn't bothered.

"The clients that have invested with us want us to be who we are," he said. "We don't get attracted to chase things that are hot. Our culture is to do the opposite, to look for places that have struggled and see if we can find values."

McBride and his colleagues are wiling to double down on unpopular stocks. During the third quarter, the firm's flagship portfolio, the Fundamental Value Fund (HWLIX), boosted holdings in APA Corp., an energy producer that's down about 30% this year. The market has underestimated APA's cash flow and the potential from its offshore Suriname project, McBride said.

Meanwhile, stock picking has led HWAAX to count on internet and software stocks for 24% of its holdings, a representation that's more than triple the technology industry's benchmark weight, the latest filing showed.

While some tech stocks look expensive based on reported earnings, their valuations can be defended after being adjusted for things such as research and marketing – expenses that eat into current profits but can benefit growth over the long run, according to McBride.

One example is Workday Inc., which makes software for business tasks such as managing human resources and trades at 40 times earnings. The company's profitability is now under pressure as it ramps up spending to attract new users. Once customers sign up, though, they tend to stay for decades.

"This is a fast-growing business and you can get it at a really good price on long-term normal earnings," McBride said. "It's probably the name that people are most surprised to see that we own because it's not in a value benchmark."

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You should consider the Hotchkis & Wiley Funds' investment objectives, risks, and charges and expenses carefully before you invest. This and other important information is contained in the Fund's summary prospectus and prospectus, which can be obtained by calling 1-800-796-5606 or visiting our website at www.hwcm.com. Read carefully before you invest.

Click on the respective link for standardized Fund performance and expenses (from the dropdown menu, select month-end or quarter-end standardized performance):

Large Cap Fundamental Value Fund
Large Cap Disciplined Value Fund
Mid-Cap Value Fund
Small Cap Value Fund
Small Cap Diversified Value Fund
Value Opportunities Fund
Global Value Fund
International Value Fund
International Small Cap Diversified Value Fund
High Yield Fund

For the Mid-Cap Value, Small Cap Value, Small Cap Diversified Value, International Small Cap Diversified Value and Value Opportunities Funds, investing in small and medium-sized companies involves greater risks than those associated with investing in large company stocks. For the Value Opportunities Fund, investing in non-diversified funds means it may concentrate its assets in fewer individual holdings than a diversified fund. For the High Yield and Value Opportunities Funds, investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments by the Funds in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. The High Yield and Value Opportunities Funds may invest in derivative securities, which can be volatile and involve various types/degrees of risk. Investments in foreign as well as emerging markets involve additional risk.

Click on the respective link for a complete list of holdings as of December 31, 2024. Fund holdings are subject to change and are not recommendations to buy or sell any security:

Large Cap Fundamental Value Fund
Large Cap Disciplined Value Fund
Mid-Cap Value Fund
Small Cap Value Fund
Small Cap Diversified Value Fund
Value Opportunities Fund
Global Value Fund
International Value Fund
International Small Cap Diversified Value Fund
High Yield Fund

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