

# That's Better Now

By **MICHAEL SHARI**

***Two straight years of strong returns have made fund investors more comfortable with risk. Don't get too comfortable.***

Investment success last year meant embracing risk. Certainly, it wasn't hard to find.

Following 2009's sharp rally, investors had to confront their fears about weak U.S. housing and employment, Europe's ugly sovereign balance sheets, May's violent flash crash, a sharp swing in U.S. political sentiment, deficit-ridden state and local governments, and the effects of easy U.S. monetary policy in order to partake in a second-half stock-market surge that many reasonable people mistrusted. Risk was rewarded.

In such an unpredictable year, the mutual-fund families that delivered the best overall returns for their shareholders didn't take money off the table, flee to defensive stocks or hide in Treasury bonds. That made for some unusual winners in our annual ranking of the best fund families. A prime example is the leader of the *Barron's*/Lipper ranking: Dimensional Fund Advisors, a quantitative-fund group with many index-like qualities. DFA was followed by Nuveen Fund Advisors, newcomer Principal Management, Oppenheimer Funds, and Waddell & Reed Investment Management.



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Scott Pollack for Barron's

Overall, they topped their rivals with strong returns in areas like emerging-market stocks, which were up 19.54%, small- and mid-cap growth and value plays, which gained 27.74% and 24.19%, respectively, and global high-yield funds, which rose about 3.50%, according to Lipper.

"At the highest level, it would come down to the amount of risk a fund manager took. In

general, riskier assets, lower credit quality and lower-quality companies generally outperformed less risky assets across equity, fixed income and various asset classes," says

Jeremy Degroot, chief investment officer of Litman/Gregory, a firm that specializes in mutual-fund research in Orinda, Calif.

The strong gains have put money in the pockets of fund shareholders and the funds themselves. Publicly held **T. Rowe Price** (ticker: TROW) saw its earnings per share increase 50.2% in 2010, to \$2.47, according to Keefe, Bruyette & Woods; they are expected to rise another 17.5% this year. **Waddell & Reed** (WDR) posted a 45.7% rise to \$1.80 a share in 2010 profit; earnings are seen increasing by 16.7% for 2011. **Janus** (JNS), **Legg Mason** (LM), **Franklin Resources** (BEN) and **Invesco** (IVZ) all reported healthy profits, though some of them might have hoped for better investment returns.

The Best Fund Families in 2010

Fund Family	Assets	Assets	Assets	Assets	Assets	Assets	Assets	Assets	Assets
1. American Century	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
2. BlackRock	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
3. Fidelity	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
4. Invesco	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
5. Janus	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
6. Legg Mason	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
7. T. Rowe Price	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
8. Waddell & Reed	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
9. Wells Fargo	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567
10. WisdomTree	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567	1,234,567

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**CAN MUTUAL-FUND FAMILIES** and their investors continue to dodge the raindrops for another year? Not only are stocks at higher levels and bond yields still low, none of 2010's risks have disappeared and a new one -- political upheaval across the Mideast and North Africa -- has appeared. The unrest in Egypt and elsewhere is a challenge for big oil companies that depend on the region for much

of their supply, says Henry Herrmann, CEO of Waddell & Reed. And the worries about U.S. states and municipalities have worsened of late, driving \$13.37 billion out of municipal-bond funds in December, a trend Degroot warns could continue.

"This could be the trend in the year ahead -- risk on, risk off -- with people thinking 'the world is coming to an end' or 'maybe I'm missing the trend,'" observes Degroot.

Possibly a little late, retail investors seem to be getting their courage up to wade into U.S. stocks again. From Jan. 1 to Jan. 26 of the new year, \$11.82 billion flowed into U.S. large-cap growth and value equity funds, more than triple the \$2.82 billion that went into international stock funds, according to Lipper. In 2010, \$74.88 billion flowed out of U.S. stock funds, while \$42.71 billion came into international stock funds, and a gargantuan \$213.25 billion poured into taxable-bond funds.

Not everyone agrees that risk levels are rising: "The risky stuff is more stable this year," says Art Steinmetz, chief investment officer of Oppenheimer.

Of course, it's impossible to time stock- and bond-market changes and the strategy that's paid off for the best big fund families -- as well as investors -- is a diversified one. Our No. 1, DFA, is a global asset manager that oversees \$206.5 billion in all and owns a mind-boggling 13,000 stocks, or about 70% of the world's publicly listed equities. Because DFA's investment process is purely quantitative, it doesn't have the option of succumbing to fear in the face of adversity. It certainly helped that DFA focuses much of its attention on some of last year's highest-performing equity areas -- value, small-cap and emerging markets.

## How Long Can It Last?

Paced by small-cap vehicles like T. Rowe Price's, some of the biggest mutual funds posted respectable gains in 2010. A turn of the calendar was good for most 10-year returns as well.

Fund/TICKER	Objective	Assets (bil)	Returns		
			2010	5-Yr	10-Yr
<a href="#">American Funds CIBA</a>	Income	\$79	8.66%	4.37%	6.94%
<a href="#">Fidelity Contrafund/FCNTX</a>	Growth	76	16.93	4.87	5.54
<a href="#">Pimco Total Return/PTTAX</a>	Int Inv Grade Deb	240	8.37	7.58	6.85
<a href="#">T Rowe Price SC Stock/OTCFX</a>	Small-cap	7	32.53	6.27	7.79
<a href="#">Vanguard Wellington/VWELX</a>	Balanced Fund	55	10.94	5.58	6.20

*Source: Lipper*

"What was important last year was to stay fully invested," explains David Booth, chief executive and co-founder of DFA. "We take diversification very seriously. We tend to be more global than other fund families. We emphasize small-cap and value stocks globally, and in emerging markets. Those factors paid off last year."

The privately held firm (Arnold Schwarzenegger is an investor) also is known for keeping a lid on costs that can rob shareholders of performance points, steering clear of some foreign markets where it doesn't believe funds can get a fair shake on prices. DFA's strong equity performance carried the day: It finished first in U.S. equities, 13th in world equities and 5th in mixed equities last year, according to Lipper.

## Ivy Just Keeps Growing

Ivy Management and its sister Waddell & Reed use the same strategies and post nearly the same results.

Rank	Family	Weighted Score	Rank	Family	Weighted Score
1.	Ivy Investment Mgmt	75.41	28.	Pioneer Inv Mgmt	55.12
2.	Waddell & Reed	73.73	29.	BNY Mellon/Dreyfus	54.77
3.	JP Morgan	72.61	30.	Aberdeen Asset Mgmt	54.63
4.	MFS Investment Mgmt	72.25	31.	HighMark Capital Mgmt	53.99
5.	T Rowe Price	71.45	32.	Federated Investors	53.44
6.	PIMCO/Allianz	70.34	33.	Principal Mgmt	51.43
7.	State Farm	68.84	34.	Legg Mason	50.61
8.	Franklin Templeton	67.48	35.	Wilmington Funds	50.35
9.	John Hancock	67.20	36.	Dimensional Fund Adv	49.42
10.	Nuveen Fund Adv	66.96	37.	Oppenheimer	48.64
11.	RidgeWorth Funds	66.26	38.	Goldman Sachs/GSAM	48.42
12.	Vanguard Group	66.10	39.	Affiliated Mgrs	48.21
13.	Delaware Mgmt	64.22	40.	Thrivent Fin'l	47.68
14.	Lord Abbett	64.01	41.	Putnam	47.10
15.	Prudential	63.95	42.	Charles Schwab	46.53
16.	Wells Fargo	62.52	43.	AllianceBernstein	45.15
17.	Mainstay Funds	62.39	44.	UBS Global Asset Mgmt	44.85
18.	Invesco	60.58	45.	DWS Investments	42.83
19.	American Century	60.01	46.	USAA Investment	42.59
20.	Virtus Investment	59.76	47.	Northern Trust	42.33
21.	Eaton Vance	59.37	48.	Russell Investment	41.09
22.	Fidelity	57.98	49.	First Investors Mgmt	38.88
23.	BlackRock	57.35	50.	PNC Funds	36.50
24.	American Funds	56.76	51.	Calvert Funds	35.41
25.	GE Asset Mgmt	56.39	52.	SEI Group	31.02
26.	Columbia Mgmt	55.73	53.	AIG SunAmerica	29.68
27.	Hartford	55.58			

Source: Lipper

Our survey weights each category of fund differently: 40.52% for U.S. equity, 14.32% for world equity, 16.46% for mixed equity, 24.52% for taxable bonds and 4.18% for tax-exempt bonds. (For our complete methodology, [click here.](#))

The stresses caused by the financial crisis as well as the mutual-fund industry's never-ending quest for scale continues to prompt consolidation. Morgan Stanley has sold most of its Van Kampen unit to Invesco, Prudential absorbed JennisonDryden under its own brand and Wells Fargo took Evergreen under its wing.

One beneficiary was Nuveen, which picked up FAF Advisors, a strong performer in *Barron's* previous rankings. Nuveen, best known for its bond expertise, particularly in tax-exempts, has added to its skills in both U.S. and foreign equities. With pretty good strength across the board, particularly in equities, Nuveen is No. 2 for 2010.

The theme that drove returns in domestic equity last year was "the return of the U.S. consumer," says Tom Schreier, the former CEO of FAF who is now vice chairman of Nuveen. Those funds that picked stocks that were poised to benefit from added consumer spending did

well. The \$1 billion **Nuveen Equity Income** Fund (FFEIX), formerly the First American Equity Income Fund, rose 17.03% last year, thanks partly to several consumer-oriented stock picks. One was **Hasbro** (HAS), the toymaker and games company, which had been hurt by investor worries about a joint venture. Hasbro rebounded on strong operating results, appreciating nearly 46.08% for the year, and generating dividends exceeding 2%.

Nuveen's taxable-bond group entered last year assuming that interest rates and economic growth would rise. As a result, the firm has started developing more floating-rate bond offerings.

"We clearly have been living off a subsidized cost-of-credit environment, with a zero-interest-rate policy from the federal government," says John Amboian, CEO of Nuveen. "That will begin to change as we are likely to see the economy rebound, so it's important to help individual investors position themselves well in a rising interest-rate environment to access income-generating investments without losing principal value."

## The American Decade

Although returns have fallen recently, American Funds holds the No. 1 spot long-term.

Rank	Family	Weighted Score	Rank	Family	Weighted Score
1.	American Funds	78.47	24.	Nuveen Fund Adv	57.27
2.	Franklin Templeton	75.44	25.	GE Asset Mgmt	56.29
3.	Mainstay Funds	74.23	26.	Lord Abbett	55.93
4.	PIMCO/Allianz	71.51	27.	American Century	55.53
5.	Ivy Investment Mgmt	71.15	28.	Waddell & Reed	55.27
6.	T Rowe Price	70.82	29.	Virtus Investment	54.83
7.	Principal Mgmt	70.37	30.	Legg Mason	54.72
8.	Pioneer Investment Mgmt	69.63	31.	Hartford	53.73
9.	JP Morgan	67.78	32.	Calvert Funds	52.50
10.	Fidelity	65.01	33.	BNY Mellon/Dreyfus	51.09
11.	Delaware Mgmt	64.14	34.	Invesco	50.86
12.	Goldman Sachs/GSAM	63.63	35.	Northern Trust	46.88
13.	MFS Investment Mgmt	63.41	36.	UBS Global Asset Mgmt	45.82
14.	Eaton Vance	63.29	37.	AllianceBernstein	45.35
15.	State Farm	62.55	38.	Putnam	41.92
16.	Vanguard Group	61.93	39.	Russell Investment	41.29
17.	Prudential Investments	61.76	40.	Charles Schwab	40.39
18.	Federated Investors	61.39	41.	DWS Investments	39.60
19.	Oppenheimer	61.23	42.	PNC Funds	36.15
20.	Columbia Mgmt	60.52	43.	USAA Investment Mgmt	35.19
21.	RidgeWorth Funds	60.09	44.	Thrivent Fin'l	35.06
22.	Wells Fargo	58.94	45.	SEI Group	29.79
23.	BlackRock	58.62	46.	First Invst Mgm Co Inc	19.11

Source: Lipper

Within tax-exempts, Nuveen tried to adapt to circumstances. "When times got more and more uncertain, we looked more and more toward bonds that were secured by essential-service revenues that would be collected under any circumstances," says Amboian. "We are much more optimistic about the environment for munis than we are worried."

One pick was a bond from New York City Water and Sewer, one of the largest water and sewer systems in the U.S., which John Miller, Nuveen's co-head of global fixed income, regards as "a natural monopoly." The fund has steered clear of continuing-care retirement communities, which have gotten dragged down in the real-estate disaster as retirees struggle to sell their homes to move, says Miller.

In another case where diversity paid off, Principal Management, our No. 3 family, did well in mixed equity and world equity. In mixed equities, Principal oversees multimanager funds run by some boutiques that it's acquired over the years or by external managers. "We think we are better off diversifying across a set of ideas," says Michael Finnegan, chief investment officer at Principal, which hasn't historically been among our leading performers. Principal launched a couple of new multimanager funds intended to produce income and protect against inflation -- or, to date, the fear of inflation.

Thus far, they seem to have been effective. **Principal Global Diversified Income** (PGBAX), which invests in six asset classes, including high-yield bonds and global value equity, was up 16.90% last year. The **Principal Diversified Real Asset** Fund (PRDAX), which blends five inflation-fighting strategies, including Treasury Inflation Protected Securities (TIPS), was up 9.92% from its inception in March to Dec. 31, 2010. "They are good diversifiers," says Finnegan. "We find managers who outperform at all different times of the cycle. We have done a good job at that."

## U.S. -Equity Funds

Dimensional's funds focus on micro-caps and real-estate stocks, two big winners in 2010.

Rank	Best	Score
1.	<b>Dimensional Fund Adv</b>	35.83
2.	<b>Waddell &amp; Reed</b>	31.37
3.	<b>RidgeWorth Funds</b>	30.56
4.	<b>BNY Mellon/Dreyfus</b>	29.38
5.	<b>Nuveen Fund Adv</b>	29.02
Rank	Worst	Score
53.	<b>DWS Investments</b>	12.10
54.	<b>GE Asset Mgmt</b>	10.39
55.	<b>AIG SunAmerica</b>	9.42
56.	<b>State Farm</b>	8.10
57.	<b>Eaton Vance</b>	7.15

Oppenheimer performed extremely well in world equity, where it ranked second. It was another good example of a steadfast investor that prospered in 2010. "When the pendulum swung, we were frightened by it but chose not to react," says CIO Steinmetz.

Instead, Oppenheimer increased its emphasis on what turned out to be one of its most successful investment themes last year -- "mass affluence," a play on the rise of the middle class in emerging markets. The **Oppenheimer Developing Markets** Fund (ODMAX) boosted its holdings of **HTC** (2498.Taiwan) a Taiwanese maker of Google Android-operated smartphones. The stock surged 158% last year on increased sales, thanks largely to a strong focus on sales in emerging markets, says Steinmetz, helping to drive the Developing Markets Fund up 26.98%.

**WADDELL DID WELL** by investing in U.S.-based multinationals that derive a higher than average percentage of their total sales from emerging markets. But the firm emphasized stock

selection instead of sector selection. "It wasn't enough to say energy was the sector to be in," says CEO Herrmann. "A very good stock can become very dicey in about two days."

That's why the fourth-largest holding of the **Waddell & Reed Energy Fund** (WEGAX), which was up 22.27% last year, is **Apache** (APA) while **ExxonMobil** (XOM) isn't even in the \$271.8 million fund's top 10 holdings. Herrmann thinks ExxonMobil's stock is too volatile -- it fell about 17% during the first seven months of last year before rebounding about 29% for the rest of the year -- because it depends on the Middle East for most of its oil supply. Apache, on the other hand, was up 16.26% last year thanks to the relative stability of its oil and gas supplies. Although Apache does operate in Egypt, the bulk of its operations are in Australia, Argentina, Canada and the British North Sea.

## World -Equity Funds

Despite the woes of its banking parent, Wilmington Funds' sub-advised vehicles managed top returns.

Rank	Best	Score
1.	Wilmington Funds	12.46
2.	Oppenheimer Funds	11.92
3.	Waddell & Reed	11.79
4.	Ivy Investment Mgmt	11.45
5.	Vanguard Group	11.34
Rank	Worst	Score
53.	Lord Abbett	2.43
54.	GE Asset Mgmt	2.42
55.	UBS Global Asset Mgmt	1.61
56.	Calvert Funds	1.32
57.	AIG SunAmerica	1.19

Of course, some fund families had to cede ground in order for DFA and Principal to rise. Last year's No. 1, Putnam Investments, dropped back to a still-respectable 14th place as its U.S. equity, mixed-equity and taxable-bond rankings dropped. Similarly, AllianceBernstein fell 30 notches, from ninth to 39th place, at the end of the second year of a turnaround effort. And Franklin Templeton, 17th a year ago and one of our long-term leaders in the 10-year category, fell back to 37th.

Some fund families seemed to find inspiration in tough times. Wilmington Funds improved last year, particularly in global equity and tax-exempt bonds, despite the distraction of its hobbled parent Wilmington Trust being acquired for a song by M&T Bank. Wilmington leapt to 16th place this year from 56th place in 2009. (For more on Wilmington's market views, see "**Going With the Pros.**")

**IVY INVESTMENT MANAGEMENT** and Waddell, its sister company, remain a tough one-two punch over five years. They are essentially separate brands for the same fund family. Philip Sanders, chief investment officer of Waddell, says large-caps look a little better than small- and mid-cap stocks. His colleague Herrmann says some of the best-performing stocks will be consumer-technology plays such as **Apple** (AAPL), **Hewlett-Packard** (HPQ)

## Mixed -Equity Funds

A unit of a big insurer, Thrivent successfully bet on small-caps and high-yielding bonds in 2010.

Rank	Best	Score
1.	Thrivent Fin'l	14.61
2.	T Rowe Price	13.67
3.	Principal Mgmt	13.20
4.	Legg Mason	12.79
5.	Dimensional Fund Adv	12.12
Rank	Worst	Score
53.	Affiliated Mgrs	1.80
54.	AIG SunAmerica	1.53
55.	Victory Capital Mgmt	1.45
56.	GE Asset Mgmt	1.19
57.	Eaton Vance	0.99

investors over the long term, and it didn't work out in 2010. It's more important for us to do well over time for investors than to have one very good year."

## Taxable -Bond Funds

Virtus got it right in the bond market by loading up on a variety of yield-spread plays like bank loans.

Rank	Best	Score
1.	Virtus Investment	21.62
2.	Legg Mason	21.55
3.	Aberdeen Asset Mgmt	20.04
4.	Pioneer Invst Mgmt	20.01
5.	Oppenheimer Funds	19.83
Rank	Worst	Score
53.	American Century	6.34
54.	Charles Schwab	6.03
55.	Northern Trust	5.77
56.	PNC Funds	5.59
57.	Mainstay Funds	5.50

and **Intel** (INTC), because their products are increasingly in demand among the emerging middle class of Africa, Asia and Latin America.

Although its recent performance has suffered -- it finished 49th this year after 31st last year -- American Funds has eased into the top spot over 10 years, toppling Franklin Templeton. One reason is that American Funds' long-term approach to investing and its preference for dividend-paying large-cap stocks helped the fund family avoid Internet stocks in the late 1990s and the ensuing dot-com crash of 2000 and 2001. "We didn't have as large a hole to climb out of as many fund families may have had," explains Chuck Freadhoff, a spokesman for Capital Group, which manages American Funds, in Los Angeles.

As to the more recent shortfalls, he says, "We have bought stocks that we believe will benefit

So what happens now?

The consensus view for 2011 is that unemployment will remain relatively high, U.S. economic growth, at roughly 4%, will outpace that of European rivals and Japan, corporate profits will rise again and inflation shouldn't be an immediate threat to the Federal Reserve's accommodative monetary policy. Emerging markets will be hard-pressed to maintain the dizzying pace of their recent stock- and bond-market gains and small-caps may lose some of their zing.

For those interested in embracing risk, muni-bond funds, oddly enough, may offer the best opportunity. Cities and states are not in nearly as dire straits as "some respected analysts" believe, says Amboian, because federal stimulus money has enabled them to keep essential services in place while their politically

ugly belt tightening makes the headlines. Until that story gets out, some bond funds will be loading up on munis while they are cheap.

Otherwise, investors should expect to hear more about floating-rate bond funds like those Nuveen is offering and commodity-related plays to guard against any whiff of inflation. Perhaps most prominently, large-cap dividend-paying stock funds will be in vogue. KBW analyst Robert Lee predicts that if domestic equity flows improve, retail buyers are likely to move into defensive and income-oriented funds. Steinmetz agrees. He expects investors to gravitate toward mutual funds that invest across a company's whole capital structure and assign measurements like dividend or cash-flow yields to stocks so they can be compared more easily with bonds. "The income story has more to play out in the stock space," he says.

In the search for yield, the way forward appears to lead toward large-cap stocks that pay dividends, companies that generate enough cash to be self-financing, and investment-grade corporate bonds -- not high-yield, high-risk plays like junk bonds. With the Standard & Poor's 500 trading at a robust 14 times 2011 earnings and government bond rates too low to compensate investors adequately for risk, investors should consider conservative alternatives.

## Tax-Exempt Bond Funds

A double winner, Wilmington lengthened maturities and took some credit risk—but not too much.

Rank	Best	Score
1.	Wilmington Funds	4.14
2.	Ivy Investment Mgmt	3.99
3.	Waddell & Reed	3.57
4.	Mainstay Funds	3.34
5.	PIMCO/Allianz	3.27
Rank	Worst	Score
53.	Frost Investment Adv	0.83
54.	Legg Mason	0.68
55.	Eaton Vance	0.53
56.	Northern Trust	0.23
57.	Calvert Funds	0.21

Source: Lipper

DFA's Booth thinks it could be the perfect time to ditch the risk of active investment management altogether and reach for an index fund. "Sometimes indexing looks pretty good," he says, adding that "the low-fee end of things" is where any investor gets paid to be at times like these.

More representative of this fund group is Stephen Walsh, chief investment officer of Western Asset Management, the bond unit of Legg Mason. "We are staying the same as last year," he says. "We are generally bringing down the risk in portfolios. We like the same trends but don't like them as much."

"Appetite for risk will work until it doesn't," adds Jeff Tjornehoj, senior research analyst at Lipper in Denver. "The time to take risk is when people are absolutely scared out of their minds." That time may have passed.

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