ETFS

How a $781-million outperforming fund manager is positioning for the next phase of the bull market

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The S&P 500 closed last week at a record high and U.S. stocks are now widely considered to be in their longest bull market in history.

For Bob Doll, senior portfolio manager and chief equity strategist for Nuveen Asset Management LLC in New York, it means investors must start to be selective when buying equities. That's especially true given the lingering threat that the trade dispute between China and the United States may escalate and lead to economic challenges.

Mr. Doll, overseer of the Nuveen Large Cap Core Fund that has more than US$781-million in assets, has been managing large-cap funds for more than 30 years and has an impressive track record of beating peers. The Nuveen's flagship fund has posted annualized returns of 14.9 per cent over the past five years, beating the 13.9 per cent of the S&P 500 and the 13.7 per cent of the Russell 1000. Its five-year returns are ranked in the top 1 per cent among 1,029 peer-group funds tracked by Morningstar.

Last October, he began to sub-advise for the TSX-listed Evolve Active U.S. Core Equity exchange-traded fund (symbol CAPS). Since inception, the ETF is up 23.9 per cent compared with its benchmark, the Russell 1000, which has had a return of 18.7 per cent. So far, the ETF has brought in just over $5-million in assets.

Last week, Mr. Doll spoke to The Globe and Mail about his investing strategy, top picks and sectors he is currently avoiding.

Can you give us an overview of the U.S. market and where things stand today?

The U.S. stock market has a massive tailwind called earnings, which are currently off the charts. To see a country, as big and mature as the U.S., producing 25 per cent earnings growth is pretty amazing. And to think it is happening not off a depressed recession, low-earnings pattern, but a ninth year of economic expansion. That is doubly amazing. It is powerful. We estimate about a third of the earnings growth on the first half of this year, which has been about 25 per cent, comes from [U.S. tax reform legislation]. Another third from revenue growth and the remaining from profit margin improvement and financial engineering. The problem is the stock market is not up 25 per cent, which means there are some headwinds. ... Last year the S&P 500 had a positive return every single month. That has never happened before and it has a probability close to zero of ever happening again.

Can you give us an overview of your investing style?

We have five themes across our portfolios. The first theme is we prefer companies that are exposed to the economic cycle rather than expensive defensive stocks.

Secondly, we are evergreen users of free cash flow as a demarcation line from stocks that are likely to outperform and stocks that are likely to underperform. We love companies that are generating cash flow, we don't like net cash users and we have a preference at this point in the cycle for companies that use that excess cash flow to reinvest in their business and show an improvement in their returns.

The third theme has been the biggest value-add to our portfolios and that is overweight companies that are highly domestically sourced earnings and therefore underweight multinational, high foreign exposure. The reason for that - coming into the year - was the U.S. tax bill was domestically friendly and so, if I am a company with earnings from all over the place, then my U.S. earnings are treated more favourably than my non-U.S. earnings. Another reason is trade. Every time [trade frictions show up] thanks to our administration, it is the multinational that gets hit the hardest so you want to be underexposed to them.

Theme four is interest rates. We are in a point in the cycle where you want to own companies that will benefit from rising interest rates and be underweight in companies that benefit from falling rates.

The fifth theme is around sectors. Some call them mid-cycle, I call them 'chicken cyclicals' and they include selected consumer discretionary, selected technology, selected financials, selected energy. We own some health care but we don't like the expensive defensive stocks.

What sectors are you currently avoiding?

We are currently underweight in utilities, real estate investment trusts and consumer staples. They are not of interest to us.

Digging into the sectors that do interest you, what are some companies that are attractive right now?

Looking at the technology sector - in the growth area - we like the credit card companies so Mastercard Inc. and Visa Inc. On the value side, Hewlett Packard Co. and Cisco Systems Inc. In consumer discretionary, we thankfully own Target Corp. Another name we own is Best Buy Co. in the consumer space. The retail names are really attractive on the thesis that Amazon isn't putting every bricks-and-mortar retailer out of business. Some of them needed a wake-up call, but these companies are responding well.

In the Evolve ETF, are there any holdings that you recently added to the fund?

We owned Boeing Co. at the start of the year, and we own it again now but we sold it in between. A wonderful company with free cash flow, but the international piece of that company is so big that when the trade stuff started we exited the stock, and that was a good thing to do, and we bought it back at a lower price.

This interview has been edited and condensed.

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