

Six Small-Cap Funds With Headroom

By [Dan Culloton](#) | 12-01-14 | 06:00 AM | [Email Article](#)

Small-cap stock funds with capacity can be hard to find, especially after a more than five-year bull market in which smaller fare have fared better than larger. Through Nov. 25, 2014, the small-growth, blend, and value Morningstar Categories have outstripped the large-cap style groups by at least a percentage point annualized each. With that in mind, here are some actively managed Morningstar Medalist small-cap funds that remain open and still have some capacity.

With \$400 million under management and an average portfolio holding market cap that's less than half that of the Russell 2000 Index and one fourth that of the typical small-blend fund, [Berwyn \(BERWX\)](#), with a Morningstar Analyst Rating of Silver, is run by seasoned managers Lee Grout and Robert Killen. Although its large appetite for tiny companies and relatively focused approach give the fund a bit of an edge, it has compensated for it by buying and holding financially sound, competitively advantaged small- and micro-cap companies. Virtually all of its holdings have some sort of competitive advantage, according to Morningstar equity analysis, which testifies to its high-quality bias. It also has tended to perform like a higher-quality fund, holding up well in rough markets, such as 2008 and 2011, and lagging in the latter stages of buoyant ones, such as 2006 and recent years.

Silver-rated [Wasatch Core Growth \(WGROX\)](#) is a little more aggressive. It recently had about 30% in stocks with Morningstar Economic Moat Ratings of "no moat"--considered competitively challenged. That, plus the fund's penchant for letting stock-picking drive sector allocations, can make it look out of step at times. The fund, however, has delivered decent risk-adjusted returns over the roughly 14-year tenure of its most senior manager, J.B. Taylor. It has done so with a compact portfolio of companies that Taylor and his colleagues have concluded can deliver steady profit growth over multiple economic cycles. It is currently around \$1 billion in assets but is still smaller than it was 10 years ago.

Silver-rated [Bogle Small Cap Growth \(BOGLX\)](#) has risk been on a tear since a dismal 2008 when it lost 48%. The quant fund's computer models that lean more on valuation and balance-sheet quality have helped results versus peers and other quant funds. The offering, however, is far from riskless. Like Berwyn, it usually has an above-average stake in volatile micro-caps. Despite periodic relative performance swings, though, it has trounced the competition and benchmark since its October 1999 inception. At \$200 million in assets, the fund looks like it has some headroom relative to other small-cap funds, but maybe not much. Manager John Bogle Jr. has closed the fund at relatively low levels in the past to preserve its ability to own more illiquid micro-caps.

The idiosyncratic [Keeley Small-Mid Cap Value \(KSMVX\)](#) remains open but isn't for everyone. Its unique approach makes it more of a supporting player than a core small-cap holding. Since its 2007 inception, it has followed the same strategy as its

older sibling ➤ [Keeley Small Cap Value \(KSCVX\)](#). It invests in spin-offs, balance-sheet restructurings, and other corporate-event-driven stories. This fund, however, has more wiggle room than the elder fund because it has a smaller asset base and wider size range. It can invest in everything from micro-caps to companies with \$7.5 billion market capitalizations. Keeley has delivered attractive, albeit lumpy, returns with this strategy both here and at Keeley Small Cap Value.

Bronze-rated ➤ [AQR Small Cap Momentum \(ASMNX\)](#) is an efficient way to capture what academics have identified as a persistent equity risk factor. It offers exposure to the momentum effect among small-cap stocks, which simply posits that stocks that have outperformed will continue to do so in the short run. The fund, offered by the firm of academic-minded hedge fund manager Clifford Asness, attempts to bottle that effect for shareholders by systematically screening for the best-performing third of U.S. small caps over the trailing 12 months, excluding the last month, and then weighting by market cap and relative momentum. This rules-based approach is mechanical, but it requires a lot of turnover, which can increase trading costs and hurt tax efficiency. Nevertheless, the fund has put up competitive results since inception.

T. Rowe Price is known more for old-fashioned, bottom-up, fundamental research, but it has some quant chops, too. Bronze-rated ➤ [T. Rowe Price Diversified Small Cap Growth \(PRDSX\)](#) has produced consistently strong results with a computer-aided approach that's much different from AQR Small Cap Momentum's. Manager Sudhir Nanda and his team use quantitative stock-picking models that pay little attention to stock and price momentum. Valuation, earnings quality, and financial-health factors drive the programs, and the fund also tends to hold on to what it buys for about five years. Broad diversification also has helped the fund keep up enough in up markets and hold up enough in down markets to post strong overall returns. The fund has grown to more than \$900 million in assets, but its small position sizes and low turnover give it more room for growth.

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Investment Considerations

Mutual Fund investing involves risk including the possible loss of principal. The Fund invests in small and micro capitalization companies which may be more volatile and less liquid due to limited resources or product lines and more sensitive to economic factors.

Past performance is no guarantee of future results.

Morningstar Analyst Rating for Funds

Unlike the backward-looking Morningstar Rating™ (often referred to as the "star rating"), which assigns 1 to 5 stars based on a fund's past risk- and load-adjusted returns versus category peers, the Analyst Rating is the summary expression of Morningstar's forward-looking analysis of a fund. Morningstar analysts assign the ratings on a five-tier scale with three positive ratings of Gold, Silver, and Bronze, a Neutral rating, and a Negative rating.

The Analyst Rating is based on the analyst's conviction in the fund's ability to outperform its peer group and/or relevant benchmark on a risk-adjusted basis over the long term. If a fund receives a positive rating of Gold, Silver, or Bronze, it means Morningstar analysts think highly of the fund and expect it to outperform over a full market cycle of at least five years. Analyst ratings do not predict or guarantee future fund performance and a high rating does not assure favorable results.

The Analyst Rating is not a market call, and it is not meant to replace investors' due-diligence process. It cannot assess whether a fund is the right fit for a particular portfolio and risk tolerance. It is intended to supplement investors' and advisors' own work on funds and, along with written analysis, provide forward-looking perspective into a fund's abilities. It picks up where commonly watched measures of the past leave off.

Research Methodology: The Five Pillars

Morningstar evaluates funds based on five key pillars--Process, Performance, People, Parent, and Price--which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis. Analysts assign a rating of Positive, Neutral, or Negative to each pillar.

Process: What is the fund's strategy and does management have a competitive advantage enabling it to execute the process well and consistently over time?

Performance: Is the fund's performance pattern logical given its process? Has the fund earned its keep with strong risk-adjusted returns over relevant time periods?

People: What is Morningstar's assessment of the manager's talent, tenure, and resources?

Parent: What priorities prevail at the firm? Stewardship or salesmanship?

Price: Is the fund a good value proposition compared with similar funds sold through similar channels?

Analyst Rating Scale

Gold: Best-of-breed fund that distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction.

Silver: Fund with advantages that outweigh the disadvantages across the five pillars and with sufficient level of analyst conviction to warrant a positive rating.

Bronze: Fund with notable advantages across several, but perhaps not all, of the five pillars—strengths that give the analysts a high level of conviction.

Neutral: Fund that isn't likely to deliver standout returns but also isn't likely to significantly underperform, according to the analysts.

Negative: Fund that has at least one flaw likely to significantly hamper future performance and that is considered by analysts an inferior offering to its peers.

Securities mentioned in the article are not a recommendation or a solicitation to buy, hold or sell. Bogle Investment Management, L.P. has no control over the content, subject matter, and timing of the original article and are independent of Morningstar Fund Spy.

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