ASSET TEST

Big Stock Funds On Top In Q1

Stock funds investing near and far turned in the best performance of the largest funds in the first quarter. Both foreign funds, led by American EuroPacific Growth, and domestic funds, led by Vanguard Mid-Cap Index, excelled in the period.

Source: Lipper Inc.

How the biggest funds fared, ranked by Q1 total return

Fund	Symbol	Assets, in bil	March	Q1	Fund	Symbol	Assets, in bil	March	Q1	Fund	Symbol	Assets, in bil	March	Q1
American EuroPacific Growth A	AEPGX	$127.94	0.20%	5.90%	Pimco Total Return Instl	PTTRX	$124.71	0.31%	2.22%	Income Fund of America A	AMECX	$99.55	-1.64%	0.96%
Vanguard Mid-Cap Index Inst'l	VMCIX	63.22	0.33	4.28	Vanguard Emerging Markets Stock Index Inv	VEIEX	64.43	-2.08	2.06	Vanguard Institutional Index	VINIX	195.95	-1.59	0.94
Dodge & Cox International Stock	DODFX	68.70	-0.59	4.20	Vanguard Total Stock Market Index Inv	VTSMX	405.52	-1.04	1.76	Fidelity Spartan 500 Index Inv	FUSEX	88.93	-1.59	0.92
Fidelity Contrafund	FCNTX	112.85	-0.49	4.05	Vanguard Total Bond Market II Index Inv	VTBIX	94.80	0.53	1.64	Vanguard 500 Index Inv	VFINX	208.78	-1.59	0.91
Vanguard Total Intl Stock Index Inv	VGTSX	146.95	-1.54	4.03	Vanguard Total Bond Market Index Inv	VBMFX	140.86	0.41	1.62	Vanguard Wellington Inv	VWELX	90.71	-0.98	0.85
Growth Fund of America A	AGTHX	147.83	-0.85	3.37	American Fundamental Investors A	ANCFX	74.01	-1.89	1.60	Franklin Income A	FKINX	94.69	-2.05	0.84
American Capital World Grwth & Income	CWGIX	89.83	-1.66	2.65	Metropolitan West Total Return Bond M	MWTRX	60.80	0.38	1.34	American Balanced A	ABALX	82.15	-1.42	0.77

BEST MUTUAL FUNDS 2015

Oppenheimer's Michael Kotlarz looks for companies that don't waste capital in their pursuit of fast growth.

Oppenheimer's Kotlarz Brings Eye For Capital Stewardship To Fund

FUND MANAGER Q&A

BY PAUL KATZEFF
INVESTOR'S BUSINESS DAILY

Since Michael Kotlarz took the reins of $5.6 billion Oppenheimer Capital Appreciation Fund[OPTFX] on July 1, 2013, the fund's relative performance has jumped.

In the 10 years before Kotlarz took the reins, the fund's average annual gain was 5.00%, held to humble returns by the 2007-09 bear market. And the performance lagged 95% of its large-cap growth peers tracked by Morningstar Inc.

Since Kotlarz took over, Capital Appreciation been among the best mutual funds, returning an average annual 22.04%. That was in the top 28% of its peers.

What's changed? Kotlarz says he's put more emphasis on finding not just fast-growing companies, but on those that are also good stewards of capital.

That focus leads him to quality stocks that provide better risk-adjusted returns than the fund had wrung from the market previously.

Kotlarz, who is 42 years old, spoke with IBD about his approach from his office near Wall Street.

IBD: *Michael, this* stock mutual fund *is like a boxer who throws effective combinations. What are your punches?*

Kotlarz: We want to create a portfolio whose backbone is good stewards of capital and balance that with true innovative growers.

The idea is that we build a portfolio that can generate good performance, but with risk-adjusted returns that can outperform both our benchmark, the Russell 1000 Growth, and our peer group in various market conditions for the long term.

IBD: *The term 'innovative growers' is self-descriptive. Elaborate on what you mean by a good steward of capital, please.*

Kotlarz: They are companies that understand the value of a share. They understand the appropriate level of growth their industry is in, and they invest accordingly.

They do not dilute the shareholder base without good reason.

They do not invest aggressively in additional capacity in an industry that is in a fixed range of growth.

They control their share count.

They understand the value of returning cash to shareholders if there isn't a really attractive investment they should make.

IBD: *How have your changes affected fund performance?*

Kotlarz: If you look at good stewards of capital, their risk-adjusted returns tend to outperform in numerous types of markets. We've built a portfolio that has better quality than its peers and (its benchmark) index. And it has a tailwind from its risk-adjusted outlook.

One of the other interesting elements is that because we look at the discipline of companies — how it manages its capital structure, how it manages cash flow — we can also predict where a company's quality is going.

We look for companies that are changing their stripes and going from being less shareholder friend-

SEE **KOTLARZ** ON **A9**

Midcap Growth Stocks Power On In Dismal March

Investors pursue safety in smaller U.S. firms as currencies are roiled

U.S. STOCK FUNDS

BY APARNA NARAYANAN
INVESTOR'S BUSINESS DAILY

March left motion-sick investors in mutual funds adrift in a sea of red.

U.S. diversified equity funds slipped an average 0.3% last month. They were up 2.5% for the first quarter as a whole.

Stock funds were buffeted by several cross-currents: A slowdown in the U.S. economy, brought on in part by a brutal winter and a labor standoff at West Coast ports. A stronger dollar that's putting the squeeze on exporters and adding to market volatility. And most of all, lying in wait but indistinct, a Federal Reserve rate hike.

"The Fed is data driven and the market seems to be Fed driven," said John Heffern, a senior portfolio manager at Chartwell Investment Partners and a co-adviser for **Vanguard Mid Cap Growth Fund**[VMGRX]. Heffern added: "There's consternation about the approaching change in monetary policy and what that means for growth."

Large-cap mutual funds, which tend to have heavy exposure to multinational companies, took the biggest hit as the dollar surged. Large-cap core funds — which hold both growth and value stocks — fell 1.5% for the month, but managed to cling to a 0.9% gain for the quarter.

Domestic-focused companies, whose bottom lines are more insulated from currency volatility than firms selling overseas, fared better. Small-cap growth funds topped, rising 1.6% in March and 5.9% in Q1.

Midcap growth funds similarly edged out their core and value

as well as making acquisitions."

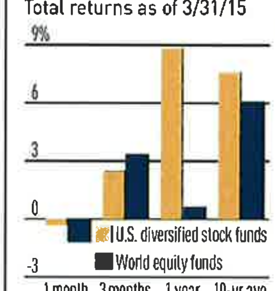
Hanesbrands acquired DBApparel, a European maker of intimate garments, in September. It took over Knights Apparel, which sells collegiate logo wear, in February.

Cruise lines **Carnival**[CCL], **Royal Caribbean**[RCL] and **Norwegian**[NCLH], also fueled VMGRX'S performance. Consumer demand has improved and "supply in terms of ships in the market has been constrained, so we're seeing yields improve," Heffern said. Cheaper energy has also benefited the lines.

Michael Arone, a chief investment strategist for State Street Global Advisors, points out that stock funds rebounded somewhat after the Fed made clear in mid-March that rates would stay lower for longer. A strong employment report in early March had sparked a sell-off in many risky assets. "That raised concerns the Fed will raise interest rates more quickly than anticipated," he explained.

U.S. Vs. The World

Total returns as of 3/31/15



Source: Lipper Inc.

Gradual rate hikes should especially benefit small caps as the cost of doing business remains lower.

A more domestic focus also makes small caps less exposed to a rising dollar or energy price swings

Oppenheimer's Kotlarz Keys In On Innovation

KOTLARZ FROM A4

ly to more of a positive steward of capital and getting the benefit of the re-rating of that company as it improves over time.

IBD: *Your weighting in* **LinkedIn**[LNKD] *as of Dec. 31 was up in comparison to Aug. 31. You're on the LinkedIn bandwagon?*

Kotlarz: We think they're a unique property within the Internet space. Generally, the types of Internet assets we get excited about are companies with a core network they can monetize in numerous ways.

The information that their network can provide creates opportunities to generate a number of additional business lines in the long term. This company can broaden beyond its marketing solutions business and its new Sales Navigator product.

Facebook[FB] is another example. It is growing well beyond the idea of an interaction of the standalone Facebook app. This also is about an underlying core network of information and of people that they can use to truly monetize in numerous business options over the long term.

Michael Kotlarz has steered Capital Appreciation Fund into such leaders as LinkedIn and Facebook.

IBD: *How would you grade Facebook's shift into the mobile arena?*

Kotlarz: They are the most innovative social media company. This company completely reinvented itself once coming public. It went from being more dependent on desktop business to a business model that benefits from mobile social media growth. In doing so, it created an opportunity for growth that did not exist before.

Unlike many of its colleagues, Facebook can give clients true fundamental information about the people and networks on numerous engagement sites it offers, whether those are Facebook, Instagram or WhatsApp. That builds compelling offerings for their customers.

IBD: *Why did your weighting in* **Harman Industries**[HAR] *more than double from last February to August?*

Kotlarz: Harman is a great example of another trend, which is the penetration of personal information and communication. We saw this initially with the adoption of the smartphone. That integration is continuing in the car.

Infotainment needs to be smarter and smarter, more personalized, and able to do more things. As it does, it increases in value and its adoption increases. In the auto is just one place, and Harman is well positioned to capitalize.

IBD: *What do you like about* **Biogen**[BIIB]*, which was your No. 2 position as of Dec. 31?*

Kotlarz: If we talk about Biogen, we should talk about large-cap biotech in general. A lot of elements make it an exciting investment opportunity. We're seeing tremendous growth, tremendous cash flow. And we're seeing a true revolution, a fundamental change not only in improving science but in the approach we take to get positive (medical) outcomes.

I love Biogen's multiple sclerosis franchise. And they have interesting pipeline opportunities both within MS and within Alzheimer's.

IBD: *This scientific revolution applies to other biotechs as well, right?*

Kotlarz: It's also applicable to **Celgene**[CELG], **Gilead**[GILD] and some others. We're seeing not only improved science but improved efficiency in dollars spent to improve science.

Current large-cap biotech names are not the same as 10 years ago. These are companies with real earnings, real cash flow, that are actually good stewards of capital. So we get to invest in innovators that are solid stewards of capital.

IBD: *Is the scientific community's ability to gather more data that shows genetic correlations to successful trial treatments a key?*

Kotlarz: People talk about Big Data as it relates to technology companies. What we're starting to see is the penetration of Big Data into biotech and pharmaceuticals.

IBD: *This is our cue to talk about* **Illumina**[ILMN]*, the leader in gene sequencing.*

Kotlarz: If we talk about the big picture and the utilization of data to improve outcomes for patients, this company is one of the catalysts.

The idea of using gene sequencing and biomarkers to understand how to make a drug work or precisely target a universe of patients for an outcome — this is one of the catalysts.

Parts of clinical trials used to be hit and miss. Now we can slice and dice information about patients in a trial. We can show that maybe a drug didn't (succeed) overall, but is extremely effective for a smaller (number of patients) based on their genetic makeup — that the trial drug doesn't work for everyone, but it works for a specific, smaller patient population.

IBD: *Does* **Sherwin-Williams**[SHW] *appeal to you at least in part because it is an all-weather grower?*

Kotlarz: What we're seeing in the U.S. is slower growth, an elongated improvement in the U.S. economy. Sherwin-Williams has a tremendous network of professional painters. And house paint is one of the highest returns on investment that a homeowner can make.

IBD: *Is the global rotation toward electronic payments why* **Visa**[V] *and* **MasterCard**[MA] *were in your top 10 as of Dec. 31?*

Kotlarz: Both benefit from long-term share gains in electronic vs. cash payments. There are tremendous opportunities for innovation in electronic pay. Apple Pay is an example.

Both are leaders. Both have some of the best business models that we've seen in financials. They are exceptional stewards of capital. They manage their share counts over the long term. They show you can get great growth and great stewardship with a compelling long-term thesis of migration away from cash to electronic transactions.

IBD: *Does creating content make* **Walt Disney**[DIS] *attractive?*

Kotlarz: We think Walt Disney is a fantastic franchise within media broadly, though it's a bit of a media conglomerate.

We're excited about companies that make content. Consumption is changing dramatically. Companies that benefit will be those with compelling content. Investors used to get excited about a movie opening in a couple hundred theaters, then about them opening in paid-TV households.

Now they can be on 6 billion wireless devices. The value of content rests on the number of potential eyes that can consume it. And that number is growing.

Walt Disney is a company that plays with that. **Time Warner**[TWX] is as well. So is **21st Century Fox**[FOXA], as they aggregate content.

IBD: *You've been paring your weighting in* **Apple**[AAPL] *since August. What are your concerns?*

Kotlarz: What we're always looking at is the risk-reward of names in the portfolio and comparing them to other names we own and don't own. In the last 12 to 18 months, Apple went from a purely innovative growth company to one that actually has exceptional capital discipline. It re-rated in its valuation (that is, its share price adjusted). As companies do that, we manage what we think the risk-reward is. Position sizes are adjusted accordingly.

IBD: *Tell me about how you manager sector weightings, please.*

Kotlarz: We wanted a more dynamic approach to sector weightings (than the fund previously had). We're willing to use large over- and underweightings in sectors. So it's important to maintain a strong level of diversification in the fund.

We do that by watching and managing relationships of names in the portfolio. We look for risk that (some people) might not expect. Some names might be in different industries, but still move in tandem because of some underlying dynamic.