CONSUELO MACK | WEALTHTRACK

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On this week's show: A rare interview with Artisan International Fund's Mark Yockey. Where is this award winning portfolio manager finding growth in a low growth world?

Mark Yockey
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CONSUELO MACK: This week on WEALTHTRACK, we have a rare interview with an award winning global investor. Artisan International Fund's Mark Yockey identifies the rare growth opportunities he is finding around the world next on Consuelo Mack WEALTHTRACK.

Hello and welcome to this edition of WEALTHTRACK, I'm Consuelo Mack.
If you are a Wall Street Journal reader as I am a recent headline probably caught your attention too. It read: "*The Dying Business of Picking Stocks"*. Co-authored by Jason Zweig a financial thought leader and WEALTHTRACK regular, its opening sentence was equally memorable: *"Investors are giving up on stock picking."*

These could be the defining investment headlines of the decade or they could be wrong.
They are certainly reminiscent of a now infamous BusinessWeek magazine cover in 1979 which read "The Death of Equities" published right before the start of a multi-generational bull market.

But this time feels different, as it always does. The stars certainly seem to be aligned for low cost, passive index funds and against higher cost. Underperforming actively managed funds, at least large cap U.S. equity funds which are the biggest players.

Performance tells the story. The percentage of U.S. large company mutual funds that outperformed the Vanguard 500 Index Fund over the last 25 years is shockingly small.
Over three years only 13% of large cap mutual funds did, over five years 11%, 10 years, a third outperformed but the percentages drop over the 15, 20 and 25 year periods.

We all know investors chase performance and flee subpar results and they are doing so en masse. According to *Morningstar*, over the last three years investors added nearly $1.3 trillion dollars to passive mutual funds and passive exchange traded funds and pulled more than a quarter trillion from active funds. It's a trend that shows no signs of letting up.

This week's guest is one of the stars of active management and he is sticking with it. He is global growth fund manager Mark Yockey who heads up the Global Equity Team at Artisan Partners. Among his responsibilities he oversees the flagship Artisan International Fund which he launched in 1995 and for which he was named *Morningstar*'s International Stock Fund Manager of the Year in 1998 and a finalist in 2012. He also runs the highly regarded Artisan International Small Cap Fund launched in 2001. Both funds are closed to new investors but the younger Global Equity Fund is open as is the newer Global Small Cap Fund.

Despite an outstanding long-term market and category beating track record his flagship International Fund has underperformed both in the last two years. I began the interview by asking him about the investment climate. How challenging is it for a growth investor?

MARK YOCKEY: It's a tough market to find growth stocks. There's very little growth in Europe. There's very little growth in the United States. Asia still has some growth because of China and some of the Southeast Asian countries, but there's not very much inflation. So to find companies that are doing something different and unique and growing a lot faster than the underlying economy is very challenging right now.

CONSUELO MACK: So what are you doing?

MARK YOCKEY: So we're doing what we've always done. We're finding companies that we think have intellectual property or have a way of doing business that they're going to get paid for, that they do something so they're price makers, not price takers, companies that have unique products or are protected by patents in one way or another that it's going to allow them to make high levels of profitability going forward.

CONSUELO MACK: We are seeing populists basically cropping up everywhere. I mean it's not just the U.S. Certainly we had the Brexit vote which was a populist vote. We have elections coming up in France and Germany and Italy, referendums on the constitution, all sorts of things happening. How do you figure that in as an investor and the impact that could have on economies and financial markets?

MARK YOCKEY: Well, you'd like to believe, Consuelo, that people do the things that are in their best interest, but I think the British have shown us that that is not necessarily the case. So what they did is I mean I don't want to say catastrophic. That sounds a little over the top, but it was catastrophic. What they're doing was absolutely ... they run a huge current account deficit, so they buy more things outside than they sell to the rest of the world. So they have to import capital, and so by voting to leave they're saying, "We don't want your capital," so they can't fund themselves, so that means the pound is collapsing, and it's almost back to where it was in 1970 before they found oil. The United States is kind of scary too because there's a lot of that rhetoric in the United States.

CONSUELO MACK: Right, very protectionist rhetoric.

MARK YOCKEY: Very protectionist, and that's the absolute worst thing we could possibly do, and anyone that's for protectionism really I think probably should take some more economics classes.

CONSUELO MACK:Let me ask you because one could accuse you of being a member of the elite. You run an investment firm. You're well educated. You travel globally. You've lived abroad part of your life. So what is it about protectionism that would be so destructive? What is it that you see as the main concern, the main problem with it?

MARK YOCKEY: The whole basis of post-World War II prosperity around the world is based on countries doing what they do best, and so countries that have a lot of money tend to produce higher value-added goods, and countries that have low-cost labor forces tend to produce things that require more manpower, and so people do what they do best, and everyone benefits from that. For instance, it doesn't make a lot of sense to grow cotton in the

United States. There's other parts of the world where that make more sense. It doesn't make a lot of sense to sew t-shirts in the United States. There are people in Southeast Asia that are way better at it and do it a lot cheaper than we do. Microsoft and Facebook and Google and all these companies that have created hundreds and hundreds of thousands of jobs across the United States, these are the companies that are exporting to the world. So if we say to other countries we're not going to buy their stuff, then they're going to say to us, "Well, Google, you're out," or "Facebook, you're out," or "General Motors, you're out." So everyone has to agree that more or less we're going to agree to trade with each other.

CONSUELO MACK: Do you have different scenarios that you operate under? Is there a protectionist scenario of what kind of companies could actually do well in that kind of environment, or is it just too theoretical at this point that you're not really applying your analytical team's skills to that possibility?

MARK YOCKEY: Well, if we really thought we were going toward protectionism in a significant way, I think you'd have to rethink the amount of money you're willing to put into equities and how you would structure your portfolio, but we think we're pretty far away from that, because our trading partners ... if Americans don't buy BMWs, it's a disaster. Right? If we don't buy things from China, China's economy is in trouble. Everyone has to trade with each other, so I don't think we're going to do that, and if you really thought that was going to happen, I think you'd probably want to have a little bit more cash and a little bit more gold.

CONSUELO MACK: You were on WEALTHTRACK I guess early last year, in March of 2015, and you were optimistic about the U.S. economy then and also the U.S. stock market. Are you still?

MARK YOCKEY: Yeah, we are. We think it's the best house in a sort of troubled neighborhood, but the U.S. is doing better than most parts of the world. The companies are extremely profitable here. The companies here throw off a ton of cash flow. A bunch in our Global Fund, a bunch of the companies that we own are generating six and seven percent free cash flow returns, and in a world where interest rates are zero and probably are not going to stray too far from that, six or seven percent on zero is a pretty good return.

CONSUELO MACK: So we've had to kind of reduce our growth expectations but, relative to what you can get in risk-free assets or whatever, that's very good.

MARK YOCKEY: It's really good.

CONSUELO MACK: It's really a good margin. So what are the kinds of companies in the U.S. that are throwing off those kind of returns? What would exemplify where Artisan is investing in this country in your Global Fund?

MARK YOCKEY: So Medtronic is a company that's domiciled in Ireland, but the headquarters is in Minneapolis, and it's in the healthcare sector. It does all the things that get you out of the hospital faster and with fewer holes in your body than you might have in the old days. So it makes hospitals more efficient. It makes doctors more efficient and hopefully puts you on the street again faster. They throw off 100 billion something market cap, and they throw off seven or eight billion dollars in cash a year. Those are the kind of numbers we love. We love companies that throw off tremendous amount of cash. You wouldn't think it. It's not a seven percent return, but it's still as significant return as Google. Google is phenomenally profitable. They have, oh, I'm guessing they have around $40 billion in cash, and they generate a 10 or 15 billion dollars in cash a year. Nestlé is another company that's not in the U.S., but they have big operations here.

CONSUELO MACK: Long-term holding of yours.

MARK YOCKEY: A long-term holding, 15 years, and you know what? Nestlé is going to be doing great in another 15 years and probably long after that. They throw off $10 billion in free cash flow a year. So we love companies like that that have good, strong businesses that are doing things that other people can't do, and they make a ton of money.

CONSUELO MACK: I looked at the Global portfolio, and I noticed that you've got a couple of retailers in there, Dollar General and I'm trying to remember what the other one is. Oh, Dollar General and ...

MARK YOCKEY: Dollar Tree.

CONSUELO MACK: Dollar Tree. So those are kind of the lower-end consumer. Right?

MARK YOCKEY: These are people that live paycheck to paycheck.

CONSUELO MACK: So what is the attraction with those two companies?

MARK YOCKEY: Well, they're not being disintermediated by the Internet. So they're not going to Google and buying their $150 pair of Nikes. These are people that are living on three and four hundred dollars a week.

CONSUELO MACK: So they are going to the stores, still brick and mortar.

MARK YOCKEY: They're going to the stores. They're going to brick and mortar stores, and they're buying things that are cost competitive, and typically they're not competing directly with Wal-Marts and the big box retailers because these are people that don't have ... they're not filling up a station wagon with $300 worth of groceries. They're going to buy $20 worth of groceries, and so they're very efficient stores. They have very low labor cost, and we think they're really well-positioned for the long term. I will tell you. On the flip side these stocks were up 25 percent earlier in the year and, with the reflection of hindsight which is also 20/20, that would have been a good time to sell them. They're now back to where we bought them, but we still think they're tremendous stories, and people are worried about Wal-Mart, but what Wal-Mart is not cutting prices as a lot of people think they are, so these stocks are really well positioned for a long time.

CONSUELO MACK: Do you own Wal-Mart?

MARK YOCKEY: No.

CONSUELO MACK: No.

MARK YOCKEY: No, but Wal-Mart's actually been a good stock this year.

CONSUELO MACK: So in a situation like that, why wouldn't you have sold Dollar Tree and Dollar General when they were at a much higher price?

MARK YOCKEY: We thought the growth was going to be a little faster.

CONSUELO MACK: I see.

MARK YOCKEY: What's happened is there's so much deflation in food, and half of what they sell is food. The pricing level has come down for everything, so the growth is slowing. An actual fact is just that there's no inflation. I saw today the price of beef is to the lowest level it's been in years.

CONSUELO MACK: And milk.

MARK YOCKEY: Milk is the same, and you go across all these categories. It costs the same as when I was a kid. A pound of hamburger is the same as 40 years ago.

CONSUELO MACK: That's deflation.

MARK YOCKEY: That's deflation.

CONSUELO MACK: Which is great for the people buying the products, terrible for the people selling the products or producing it. Speaking of groceries, Amazon is getting into the grocery business in a major way. Amazon is one of your holdings. So tell me about the Amazon business model which has always perplexed many people. Clearly it has not perplexed you because you've invested in the company. What's the appeal of Amazon?

MARK YOCKEY: Well, what Amazon does is they are the epitome of price transparency so you can see what everything costs. Then they have a supply chain to deliver it to you better, faster, quicker than anybody else does, and they have three businesses. The first business is selling the stuff that they have. The second business is selling things for other people. So you can actually run your whole business on Amazon, and the third business is what they call the AWS business, the cloud business where they're helping companies put their data on the cloud and run their businesses on the cloud. All three of these businesses are booming, so their retail sales are growing at 20 percent. Retail sales in the United States are growing at two or three. So every year they're gaining share at a massive rate, and the cloud business itself is probably worth 30 or 40 billion dollars, and that's growing at 50 percent a year right now, and we expect that to continue for some time too. So optically the stock looks expensive, but they're disintermediating so many retailers around the world that we think the stock is going to be good for a long time.

CONSUELO MACK: Let me ask you about a business that is changing but not in a way that Amazon is, and that's the banking industry. At one point you owned JPMorgan Chase and you owned Citibank. What is your view of the banking industry now?

MARK YOCKEY: Chase is a good bank. It's well run, and they have enough capital, so a lot of the problems they avoided in 2008 and 2009. Actually the management's excellent. So do you want to own it? We don't see a lot of growth there. They'll benefit if rates go up. The big depository banks in the United States and all over the world are big beneficiaries if you think rates are going to go up two or three times, and we don't think rates are going to go up very much because we don't think the world is inflating. We think the world is sort of flat at best in inflation. So that's why we're cautious on the banks, but if you want to own a bank for the next five years, JPMorgan is a great one to own.

CONSUELO MACK: Do you want to own a bank for the next five years? Do you at Artisan?

MARK YOCKEY: One or two but not a whole bunch, but JPMorgan, and we were talking earlier about Wells Fargo. Wells Fargo is something that I would probably look at this point too.

CONSUELO MACK: Because it's just been killed.

MARK YOCKEY: Beaten up. Yeah, it's been beaten up.

CONSUELO MACK: Really beaten down. The banking industry is heavily regulated, more than it was before. It had to be run much more conservatively. It's had to raise more capital. It can't make money in the proprietary trading in the areas they were able to make it before. Would you consider it to be a growth industry?

MARK YOCKEY: No.

CONSUELO MACK: Or it's not a growth industry anymore.

MARK YOCKEY: No.

CONSUELO MACK: It was.

MARK YOCKEY: It was. It was, but when you have to carry two or three times more capital just mathematically, and then you take away the best businesses, so you take away the top and you double the bottom, so the returns, they're not 30 anymore. The returns are seven and eight. The best of the banks are earning 10 and 11. So I mean it's okay. They're okay, but the regulators want them to turn into utilities, and that's slowly what they're turning into.

CONSUELO MACK: You and I had talked in the past about category killers, and we just talked about Amazon being one, Google being another, but Alibaba in China for instance is a company that you own as well. What are the other category killers that might not be as familiar to United States investors?

MARK YOCKEY: So BABA is a great story, and think of it as Amazon without the distribution. So people in China, it's even more difficult to go shopping in China than it is here. Logistics are a nightmare. Traffic is a nightmare. Pollution is a nightmare. If you can do your shopping at home, you're going to do your shopping at home. So e-commerce is growing at 25 percent in China. We expect that to continue for a number of years. These guys actually, even maybe more in some ways than Amazon, these guys are partners with the retailers that use them as a storefront. It's called TMall, and so they'll help ...

CONSUELO MACK: How does that work? I mean how does the partnership work?

MARK YOCKEY: Well, they'll help the manufacturers and the retailers actually run their inventory, so they'll work with them. So you become a partner, and once you become a partner it's hard to get rid of your partner. Of course, that's the idea. And so the great thing about these businesses is it's called the 3P business, the business they're doing for third parties, these other retailers. It's all a commission-based business. Now Wall Street commissions have collapsed, but e-commerce commissions are 15 percent. Fifteen percent is really good.

CONSUELO MACK: Really good.

MARK YOCKEY: So it's the same on Amazon. Amazon is getting 15, and if you use their fulfillment centers, you're getting 20 percent. So these are wonderful businesses, and they're phenomenally profitable. The problem is they're reinvesting, but they're reinvesting because the business is growing so fast, not because they're doing dumb stuff.

CONSUELO MACK: You're not concerned about it being a Chinese company and the Chinese government and the whole political aspect of it. You think Alibaba is going to survive.

MARK YOCKEY: I wouldn’t say we don’t watch it closely, as closely as you can watch a company in China, but we think they’re on the side of the government, and we think the government wants BABA and Baidu and Tencent to be successful. So the head of Alibaba was just in Indonesia because they’re setting up e-commerce in Indonesia, and he was just in Thailand. So he’s a good flag carrier for the Communist Party to show that they’re not just locking up dissidents; that they can help Southeast Asian countries become more modern and more efficient.

CONSUELO MACK: This is Jack Ma.

MARK YOCKEY: Jack.

CONSUELO MACK: What are some other companies that would not be on our radar screen? I’ll give you one that you had mentioned to me, AJA. It’s an insurance company that was spun off of AIG. Right?

MARK YOCKEY: Oh, AIA.

CONSUELO MACK: AIA.

MARK YOCKEY: That’s a wonderful business.

CONSUELO MACK: So tell us about AIA.

MARK YOCKEY: They sell life and health insurance to five billion Asians, and 4.9 billion of the five billion don’t have any health and life insurance, so the business is growing at 25, 30 percent a year. It’s going to continue to grow that fast. They’re only in six provinces in China. One day maybe this year, maybe next year, maybe the year after, they’re going to get a license for all of China. So they’ll sell at 1.3 billion people instead of just a couple hundred million people. So this is a business that doesn’t exist. These are all new customers, so it’s sort of like life insurance companies in the United States in the ‘20s and ‘30s. If you look back at the stock prices of life insurance companies in the ‘20s and ‘30s, they were really good businesses. AIA...

CONSUELO MACK: They were really cheap. People didn’t understand them, and they were really good businesses.

MARK YOCKEY: Brilliant management. The guy is one of the sharpest managers I’ve ever met, and he really wants the company to do well, and he makes good decisions, and he’s very thoughtful. That’s the kind of thing we look for in a management.

CONSUELO MACK: A couple of big trends that you and I had talked about over a year ago, and that was the dollar would be strong, that the U.S. would outperform Europe and that commodity prices would stay low. Those were kind of the big trends that affected a lot of businesses. What are the big trends now that you see?

MARK YOCKEY: I don’t think they’re going to change a whole lot.

CONSUELO MACK: Dollar’s going to continue to be strong.

MARK YOCKEY: I think the dollar’s going to be strong. We’re doing better than the rest of the world. We think commodity prices are going to maybe not go down from here, but they’re not going to go up a lot. Oil might do a little better, but that’s if they can cut a deal with the Saudis and the Russians, and historically they haven’t been very good at that.

CONSUELO MACK: No, they’ve not.

MARK YOCKEY: So we don’t think things are going to change a lot. Ironically, very low interest rates or zero interest rates help the companies that have the most difficulty, so the companies that are doing the best this year are the companies that have the most debt and are the most commodity-oriented. One day that’ll change, and people will go back to investing in companies that have intellectual property and high profit margins and sell unique products, but for right now commodities are doing extremely well, the companies that produce commodities.

CONSUELO MACK: Another big trend is the fact that investors are moving from active managers to passive index funds. Talk to me about that trend and how it’s affecting you as an active manager. How challenging is this environment?

MARK YOCKEY: Well, that would be one of those trends that we’re not really ecstatic about. We think over time active managers, at least in our case, we’ve been able to add value, although I’ll grant you that this year we’ve not added value, but on a long-term basis we’ve added quite a lot of value, and we think we will in the future. There is something going on called factor investing which is a derivative of passive investing, and it complicates things because a lot of ...

CONSUELO MACK: They’re doing value, momentum, yield. They have all these different categories of how they screen and put together the indexes.

MARK YOCKEY: It’s all being driven by computers, and so the stocks don’t matter, but they will matter because ultimately stock prices follow earnings, and we still think if you can pick the companies that grow their earnings, you’re going to make money for your investors. We’ll have to see if that works. We think it will.

CONSUELO MACK: One investment for a long-term diversified portfolio. What should we all own some of?

MARK YOCKEY: Amazon and Google are going to be great stocks for a long time. They're doing things that very few other people are doing. They're hiring very bright people. They're extraordinarily profitable which gives them a lot of flexibility in how they go about doing things, and they don't limit themselves by how they view the world. They have a very broad view of the world, and so we think they can keep growing these businesses very rapidly. They're disintermediating huge parts of the global economy, and we don't think that's going to stop.

CONSUELO MACK: We'll leave it there. Mark Yockey, thank you so much for joining us on WEALTHTRACK.

MARK YOCKEY: Consuelo, nice to be here.

At the close of every WEALTHTRACK we try to give you one suggestion to help you build and protect your wealth over the long term. This week's Action Point is: If you want to beat the market you have to do something different from the market. There is no question that the vast majority of active fund managers, especially in the widely covered large cap space underperform the market. But in less transparent, less researched smaller and less liquid markets active managers can still make a big difference. A combination of index funds and actively managed funds in areas such as corporate and municipal bonds, small cap stocks, and internationally based companies still makes sense.

We will continue to seek out the best in class active managers on WEALTHTRACK and bring them to you.

Next week we have another rare interview with a great investor. Gotham Asset Management's Joel Greenblatt, a noted value investor and hedge fund manager who has created a new hybrid fund, combining an index fund with his long/short strategies. We'll find out what's behind his Gotham Index Plus Fund.

To hear Mark Yockey's succinct summary of the importance of the presidential election go to the extra feature on our website, and let us know what you think on Facebook and Twitter.

Thank you for watching. Have a great weekend, a fun Halloween, and make the week ahead a profitable and a productive one.