Reprinted from Morningstar Advisor
December/January 2012

Wedgewood's Lessons Pay Off

By Dan Culloton

The St. Louis firm takes ideas from indexers and value investors to craft its solid large-cap growth strategy.

Wedgewood Partners is defined by its contradictions. Its founder, Anthony Guerrerio, is a New York native who moved to the Midwest to be a financial entrepreneur. Chief investment officer David Rolfe is an avowed growth investor whose idols include value-investing icons Mason Hawkins and Warren Buffett. Rolfe and his colleagues are active managers who not only agree with the arguments for passive index investing but also use them to justify their philosophy and strategy. And in volatile times that have driven many professional and amateur investors to do something, anything, to improve returns, Wedgewood has succeeded by keeping things simple and trading infrequently.

"We haven't tried to reinvent the wheel here," Rolfe says.

Indeed, Wedgewood hasn't invented anything. Plenty of stock-pickers profess to abide by the tenets of the firm's large-cap growth strategy. Morningstar fund analysts' files are stuffed with presentations touting the virtues of searching for reasonably priced shares of firms with strong competitive advantages, growth, profitability, balance sheets, and management. The pitch is, frankly, a little hackneyed.

Self-awareness, humility, and patience set Wedgewood apart. Working from a modest colonial-style office building at the bottom of an I-64 exit ramp in St. Louis, the firm, which has $1.2 billion in assets, knows that it faces stiff competition from thousands of smart investors. "We compete in a very, very efficient space," Rolfe says. "We know we don't have an information advantage, and we are humble

enough to know that we don't have an IQ advantage," Rolfe says. But the firm does have a structural advantage, he believes. Rolfe and his team—Michael Quigley and Dana Webb—limit their circle of competence, get to know a handful of stocks very well, home in on those they think can grow faster and longer than other investors expect, bide their time for the right moment to buy, and then let the market do the math. "If we can build portfolios that are this growthy and not have to pay up for it, then we have a horse race," Rolfe says.

Wedgewood has run its race well, so far. Since its Sept. 30, 1992, inception through Sept. 30, 2011, the Wedgewood Concentrated Large-Cap Growth separate account has gained a cumulative 725.5% versus 554.8% for the typical large-growth separate account, 263.5% for the Russell 1000 Growth Index, and 331.6% for the S&P 500 Index. The account has achieved those results without much more volatility, as measured by standard deviation, than the Russell 1000 Growth Index, even though it's focused and benchmark-agnostic. The firm's only and still-young and small mutual fund, RiverPark/Wedgewood Fund RWGFX, has gained 3% annualized in the year ended Sept. 30, beating the average large-growth fund and the S&P 500 but lagging the Russell 1000 Growth by about 30 basis points.

The Kid From UMSL

That record is the product of the pairing of a West Point graduate who grew up in the Bronx and a Midwestern frat boy. In the early 1980s, Rolfe went to the University of Missouri to study engineering. He joined a fraternity and fell in love with his future wife—"Two of the best things in my life," Rolfe says—but engineering didn't pan out. So, Rolfe returned to his native St. Louis to study finance and economics at the University of Missouri-St. Louis, where he got hooked on the Financial News Network, a precursor to CNBC, and the approaches of legendary investors like Buffett, Hawkins, Sir John Templeton, and T. Rowe Price. Rolfe started a student investment club and began plotting his career. "That's what I wanted to do," Rolfe says. "I wanted to invest." The easiest way for a kid from UMSL, as locals refer to Rolfe's alma mater, to get into investing was as a stock broker. After a few "incredibly unproductive" years at Westport Financial Group and PaineWebber, Rolfe became a portfolio manager at Boatmen's Bank, which had St. Louis' largest trust department. There he honed what would become his and Wedgewood's competitive edge.

Rolfe knew from his education and reading that the stock market was pretty efficient and hard for active managers to beat. Yet he also knew from studying great stock-pickers that the market was not perfectly efficient. "There were enough investors who were outperforming the market on a consistent-enough basis to refute key elements of the efficient-market hypothesis," he says. "There is a big gulf between relatively efficient and perfectly efficient."

That investors often mispriced securities as they swung from fear to greed wasn't an original insight. Few managers seemed to take full advantage of the inefficiencies, though. Those who did seemed to have one thing in common. "Whether they were growth or value," Rolfe says, "They viewed investing more like a successful business owner than a green eyeshade investment analyst."

To Rolfe that meant buying and holding as well as being willing to look different from the benchmark and the typical large-growth portfolio. "We choose not to manage money like others," he says.

After four years of putting theory into practice at Boatmen's, Rolfe's eye began wandering for more entrepreneurial opportunities. When he heard of the impending retirement of the chief investment officer of Wedgewood, which Guerrerio founded in 1988 after running Mark Twain Bancshares' brokerage for nearly a decade, Rolfe applied. His passion and voracious reading appetite sorted him from the pack of candidates. "He lives, eats, breaths, thinks, and sleeps stocks," Guerrerio says. "In this game you have to have a passion for it." Guerrerio hired Rolfe in 1992 and gave him carte blanche to remake the firm's investment process. Giving a blank slate to a young manager was risky, but Guerrerio had learned to value native intelligence, drive, and work ethic more than credential, tenure, or rank. The former Army nuclear missile battery commander put himself through Harvard Business School while starting a family and worked at Salomon Brothers before an MBA buddy lured him to Mark Twain Bancshares in 1979. At the old Salomon Brothers "if they spotted talent, they would give them a shot," Guerrerio says. "That was in my blood."

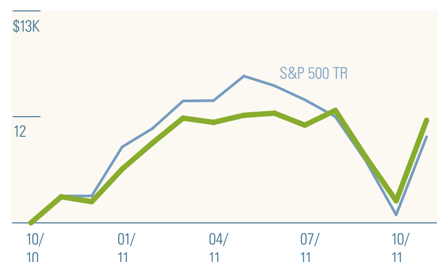
Indeed, Guerrerio continued giving underdogs their shots. Webb, who was one of Guerrerio's brokers at Mark Twain, was Wedgewood's first employee. After she took a break to raise her children in the 1990s, he not only welcomed her back in 1997 but also made her a portfolio manager in 2002 after she earned her MBA and CFA. "I watched her grow," Guerrerio says.

Fellow investment team member Quigley joined Wedgewood as an intern after graduating from high school in 2000, in part because his parents were Guerrerio's friends and neighbors. He worked at the firm while studying finance at St. Louis University and joined Rolfe and Webb after his 2004 graduation. "[Guerrerio] gives you as much rope as you want," Quigley says. "I tried to take advantage of that."

Preferring home-grown talent has helped keep the boutique unique. "They don't come in with a biased approach," says Steve Snyder, director of equity investments for Fortigent, an investment consultant. "In St. Louis, they're definitely removed from the Manhattan mind-set and focused on the long term."

The tall, garrulous Rolfe, whose office is a thicket of teetering stacks of books, annual reports, and journals, clearly drives the process, though, which creates a bit of key-man risk. "If Dave was ever to decide to leave Wedgewood, we would part ways," Snyder says.

RiverPark/Wedgewood RWGFX



Category	**Fee Level**
Large Growth	Above Average
Morningstar Rating	**6-Mo Anl Total Rtn** (%)
—	–0.61
Minimum Investment	**6-Mo Anl TR % Rank Cat**
$1,000	1

Data as of Oct. 31, 2011

Not that Rolfe, who owns about 45% of Wedgewood, is likely to leave. Snyder isn't worried. Wedgewood remains on Fortigent's recommended list for advisors, regional banks, and trust departments looking for concentrated managers to complement passive large-cap holdings, and Snyder says it can also serve as a portfolio linchpin for the right investor. "[Wedgewood's] focus on valuation and their market cap would make them acceptable to be held as core holding," he says. "But the big caveat is that, given their concentration, investors have to know that there could be some substantial deviation from the Russell 1000 Growth from time to time."

Growth-Focused

The portfolio may not look or act like its index, but it has been reliably growth-oriented and -focused. Since its September 1992 inception, the Wedgewood separate account has rarely strayed outside of the large-cap growth area of the Morningstar Style Box, and it has held from 17 to 22 stocks. Its cash stake approached 10% of the portfolio in March 2007, but the managers don't usually make asset-allocation calls and have kept the account close to fully invested most of the time.

As of Sept. 30, the account invested about half of its money in financial and health-care stocks, with another 30% in technology companies. It held nothing in materials, consumer, real estate, utilities, or communications stocks. These sector biases, as well as the manager's tendency to load roughly 60% of its assets in its top 10 holdings, court risk, yet Rolfe contends that it's controlled by careful security selection, valuation sensitivity, and an absolute rather than a relative return mind-set. "People talk about risk. You want to know what risk is?" Rolfe asks. "Risk is sitting in front of the Widow Jones in late 2008 and telling her why her portfolio is down 50%."

The portfolio's holdings tend to be the kind of high-quality fare that holds up well in downturns. Every one of them has some sort of moat, or competitive advantage, according to Morningstar's equity analysts. Indeed, the weighted average moat rating of the RiverPark/Wedgewood Fund, which is a clone of the Wedgewood separate account, is higher than 90% of other large-cap funds. The Wedgewood portfolio also has higher average cash flow and earnings yields and a lighter average debt load than the typical Russell 1000 Growth constituent. Focusing on larger, more-profitable companies has helped Wedgewood do better than its large-growth peers in past bear markets, such as those in 2002 and 2008.

Like other growth managers, Rolfe, Webb, and Quigley perk up when they see fast revenue and sales growth and high returns on equity, capital, and cash flow, but they are not wedded to such screens. They want market leaders who can grow faster than expected and will look inside and outside growth managers' typical hunting grounds for them.

You'd be hard-pressed to find a large-cap growth manager who doesn't own Apple AAPL, for example, but Rolfe contends that it's still underappreciated. Cofounder and prime mover Steve Jobs, who died in October, is irreplaceable, Rolfe says. But the company has solid senior leadership, expanding beachheads in phones and tablets, fanatically loyal customers, and exciting designs for cloud computing and other products. Rolfe thinks Apple can earn about $10 more per share in 2012 than the current consensus forecast of about $33 per share. "These guys are in a whole different lane going faster than anyone else and not even breaking a sweat," Rolfe says.

Rolfe considers Berkshire Hathaway BRK.A a growth stock primarily because the businesses that Buffett has assembled have the potential to fuel book value growth for years to come. He thinks the conglomerate can exceed the growth of the S&P 500 by several hundred basis points. "How many CEOs can you say have built a business that is a permanent cash-generating compounding machine?" Rolfe asks.

Wedgewood's investment team reviews ideas weekly but rarely makes precipitous changes because any fresh idea has to be better than the portfolio's worst idea. "This is where new and exciting ideas go to die," Rolfe says. "New ideas have to be better than marginally better. Otherwise you're just adding turnover."

The firm's track record is gaining attention. Guerrerio and Rolfe have listened to buyout offers but do not intend to sell. They would rather grow at their own pace and even close the strategy if asset growth ever threatened to become an impediment. "You can't build a big firm doing this," Rolfe says.

With no outside owners, Wedgewood has only one constituency to please: its clients. "I know if I take care of them, everything will work out in the long run," Guerrerio says. M

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