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MARKETS | FUNDS

This Fund Beats the S&P 500 Year After Year. Here's Its Secret.

By Debbie Carlson

Active managers who beat their respective indexes are a rare breed. Those who can consistently beat the S&P 500 are rarer still.

Ann Holcomb, research director and portfolio co-manager of the $10.3 billion T. Rowe Price U.S. Equity Research fund is in this exclusive club, having bested—along with a team of about 30 research analysts—the S&P 500 index for the past five years on an annualized basis.

U.S. Equity Research is a Morningstar five-star gold-medal fund. It has no load and charges a low, 0.45% annual fee. Year to date, it's up 18.6%, versus the S&P 500's 15.5% gain. The fund beats the broad market and its Morningstar peers on a one-, three-, and five-year annualized basis. Over the past five years, the fund has returned 12.3% versus its peers' average return of 10.1% and the S&P's 11% gain. Those wins put U.S. Equity Research in the top 9% of its peers.

The fund's strategy is twofold. Individual portfolio analysts conduct deep bottom-up fundamental research to find stocks in their respective industry coverage areas and overweight their top picks, while Holcomb and her portfolio co-managers, Jason Polun and Jason Nogueria, maintain strategy oversight.

U.S. Equity Research's industry weights are similar to those of the S&P 500, and analysts get a representative slice to manage, overweighting preferred names and selling least-preferred stocks to buy others. The weighting differences are slight, as the total portfolio is limited to a 1% overweight or underweight versus the index, but it's enough to make a material return difference.

Analysts may own a handful of non–S&P 500 large-cap stocks, although the entire portfolio's non–S&P 500 weighting is limited to 10%. It's currently at 4.5%. Sometimes, U.S. Equity Research owns names before they're added to the index. Lululemon Athletica is a recent example, and Holcomb says the fund owned Google for about six months before it joined the S&P 500.

"That can be a nice source of relative performance," she says, as a company's share price often gets a bump when the stock is added to an index because index-following funds must add the name.

The portfolio managers work closely with the analysts in scrutinizing market exposures, adjusting position size as needed, based on the risk profile of both the individual investment sleeves and the entire portfolio.

"Each analyst has to understand what's different about their space, what makes the stocks work within their space," Holcomb says. "As portfolio managers and directors of research, we're laser-focused on 'Oh my gosh, what could go wrong next year?' "

Holcomb was named co-manager and research director in 2015, but she has been involved with the fund since its 1994 founding by William Stromberg, who later served as T. Rowe Price's CEO, and Richard

T. Rowe Price U.S. Equity Research

	Total Return		
	1-Yr	3-Yr	5-Yr
PRCOX	20.8%	9.9%	12.2%
Large Blend Category	14.3	8.2	10.1
Top 10 Holdings			
Company / Ticker		% of Net Assets	
Microsoft / MSFT		7.4%	
Apple / AAPL		6.9	
Alphabet / GOOG		4.0	
Amazon.com / AMZN		3.5	
Nvidia / NVDA		3.4	
Meta Platforms / META		2.0	
Eli Lilly / LLY		1.8	
UnitedHealth Group / UNH		1.5	
Tesla / TSLA		1.4	
Berkshire Hathaway / BRK.B		1.3	
TOTAL		**33.2%**	

Note: Holdings as of Oct. 31. Returns through Nov. 6; three- and five-year returns are annualized.
Sources: Morningstar, T. Rowe Price

Whitney. Their process of relying on analyst picks—with the directors of research providing extra accountability—remains intact, she says.

Holcomb and her co-managers oversee distribution of active weights in the portfolio as well as the risk profile of each sleeve, including subsectors, while considering the fund's overall style, factor, and sector allocations to ensure that the whole portfolio shadows the benchmark. These risk-related measures allow U.S. Equity Research to produce higher risk-adjusted returns versus peers, according to Morningstar.

"That helps isolate what we think our analysts do best, which is select stocks in their small area of expertise," she says. "Over the past 24 years, that has led to consistency of relative returns."

Holcomb credits this year's strong performance to the team's stock selection, an impressive feat, given that the S&P 500's rally was driven by just a handful of tech names. Overweighting tech stocks such as No. 3 Nvidia undoubtedly helped U.S. Equity Research, but she says the fund's gains were broadly based.

"I'm not sure I ever remember a year where we had about 90% of our analysts outperforming their own benchmark. It's truly astounding," she says.

The fund has held Nvidia since 2018, and Holcomb says the analyst still has a "very favorable" view of the high-end graphics processing unit company. She credits how analysts' deep research leads them to uncover insights or differentiated views before the market does. The analyst expects the company's moat to expand as it gets into autonomous driving and other markets, suggesting it has more room to grow.

U.S. Equity Research also motored higher this year on an overweight in FedEx stock. She notes that the analyst pinpointed a valuation disconnect between FedEx and rival United Parcel Service. FedEx improved some operations and capital allocation, while freight carrier Yellow's bankruptcy boosted FedEx's freight business. Another outperforming transportation name, Old Dominion Freight Line, is gaining market share and has improving margins and a strong management team, she says.

Monster Beverage, which is also overweighted in the fund, has outpaced other consumer-goods companies, even as inflation has compressed multiples for most beverage makers, including Monster. The company increased margins by raising prices and reducing supply-chain costs, while demand for energy drinks is expected to stay strong.

Geopolitical issues, inflation worries, and concerns over interest rates are likely to keep investors on their toes into the year's end after leading to market malaise in October. Investor pessimism and market volatility could lead to stock mispricings, Holcomb says, giving the nimble U.S. Equity Research team opportunities to add new names or adjust portfolio weightings.

"When we identify differences in fundamentals, versus where the market thinks they are, that's really how we win long term," she says.

EXPLANATORY NOTES—ARTICLE REPRINT

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Average Annual Total Returns as of 9/30/23:

	1 Year	3 Years	5 Years	10 Years	Gross Expense Ratio[1]	Net Expense Ratio[1]
T. Rowe Price U.S. Equity Research Fund	23.85%	10.90%	10.47%	12.23%	**0.45%**	**0.45%**
S&P 500 Index	21.62%	10.15%	9.92%	11.91%		

[1]As of the most recent prospectus.

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Risks: Because growth stocks have higher valuations and lower dividend yields than slower-growth or cyclical companies, the fund's share price could decline further in market downturns than non-growth-oriented funds. The fund's growth investing style may become out of favor, which may result in periods of underperformance. Small- and mid-cap stocks generally have been more volatile than stocks of large, well-established companies. International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional and economic developments.

The fund may have other share classes available that offer different investment minimums and fees. See the prospectus for details.

As of 10/31/23, T. Rowe Price U.S. Equity Research Fund, Investor Class Morningstar Ratings™ in the Large Blend category: 4 stars, 4 stars, and 5 stars out of 1298, 1188 and 885 funds, for the 3-, 5-, and 10-year periods, respectively. The Overall Morningstar Rating™ for a fund is derived from a weighted average of the performance figures associated with its three-, five- and ten-year (if applicable) Morningstar Rating™ metrics.

The Morningstar Rating™ for funds, or "star rating", is calculated for funds with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star.

As of 11/30/23, the percentile rankings for the T. Rowe Price U.S. Equity Research Fund in the Morningstar Large Blend category were: 8th out of 1,435, 7th out of 1,192, and 4th out of 886 funds for the 1-, 5-, and 10-year periods, respectively. Rankings are based on total returns and are net of expenses.

Analyst Driven 10% - Based on Morningstar's assignment of a person (analyst) or machine (quant engine) to each pillar and then allocated to a predetermined weight in the scoring model.

Data Coverage 98% - Based on the number of data points available to the quant engine compared against the weight of that pillar.

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