Fund in Focus: Vanguard PRIMECAP

Ray McGrath
Investment Consultant, Cammack Retirement Group

With nearly $50 Billion in assets, Vanguard PRIMECAP is one of the largest actively managed funds in the large cap equity space. PRIMECAP was incepted in November 1984 and is managed by sub-advisor Primecap Management Company. The main objective of PRIMECAP is to seek long-term growth of capital. Investing in stocks of companies with above-average prospects for continued earnings growth, strong industry positions, and skilled management teams, the fund's portfolio consists predominantly of large- and mid-capitalization stocks. PRIMECAP may also invest in companies with below-average earnings but bright prospects for earnings growth.

To illustrate the success of the fund, a $10,000 investment in PRIMECAP three decades ago would be worth over $600,000 today, more than double the S&P 500 index[1]. However, Primecap Management, the adviser behind the fund, is hardly a household name. That is partly by design; the firm rarely, if ever, talks to the press. The team that manages the fund, Theo Kolokotrones, Joel Fried, Alfred Mordecai and M. Mohsin Ansari, also manage five other top-performing funds. All told, Primecap Management manages $79 billion in mutual funds, plus $24 billion more in defined benefit pension and endowment funds[2].

The Primecap managers limit the number of clients, as they view sales and marketing as a distraction from their primary goal of investing. As a result, PRIMECAP has been closed to new plans since 2014. An actively managed fund can grow too large (i.e., it can have so much money that it cannot easily/ successfully invest newly acquired dollars). With a fund being "too large," fund managers either have to keep significant cash on the sidelines or find suitable investments, even after they have "enough" invested in their first choice investments. If the fund decides to change top picks, it may have too many shares to easily close out its position at a reasonable price in a timely manner. Additionally, the constant influx of "new" investors tends to attract more short-termers, whose buying and redemption of shares cause a burden on the management team investing/redeeming the cash flow.

The primary strategy for PRIMECAP is to invest in growing companies that trade at bargain prices. The management team looks for a catalyst, such as the introduction of a new product, the arrival of new executives or a restructuring that they think will push the stock higher over the next three to five years. There are no explicit market cap limits on the stocks that the managers buy, but due to the fund's large size, it holds less than 8% in small and mid-cap stocks.

Investors should note that the fund is concentrated in a few sectors. However, this strategy has produced strong long-term results, thanks largely to healthcare and informational technology stocks, as these and industrials lie at the heart of PRIMECAP. Healthcare and information technology

[1] Morningstar.com
[2] https://www.fool.com/investing/2016/09/29/vanguard-primecap-fund-an-active-fund-even-indexer.aspx; Vanguard.com; http://primecapmanagement.com/literature_and_forms.html

stocks make up over 70% of the fund's assets, with no other sector accounting for more than one-tenth of the fund's assets. The fund is not invested in the utilities sector and consumer staples form only 0.4% of the fund's portfolio. Compared to the S&P 500 index[3], PRIMECAP is markedly underweight in consumer discretionary, consumer staples, real estate and telecom services funds. Most sectors have broadly maintained their portfolio weights for the past three years. The fund has recently increased its holdings in financials, as the prospect for a reduction in regulation looms, and a steeper yield curve and higher interest rates could improve margins.

The fund tends to exhibit lower volatility than the average large growth fund, which makes it a good choice for a retirement plan and long-term investors. On average, the managers hold stocks for 20 years. This longevity can lead to periods of underperformance in the short term, but has generally outperformed over the long term. From 2010 through 2012, the fund's technology and healthcare holdings were responsible for underperformance, but outperformed in 2013 and 2014. During the 2008 market crash, the fund lost less than 95% of its peers[4]. More recently, the fund's performance was impacted by its biotech holdings, which came into focus during the presidential election; however, they have since recovered.

While the fund underperformed the S&P 500 in 2016, it remains a good long-term choice for retirement finds, with top decile performance for the 1-, 3-, 5- and 10-year periods. Additionally, the fund has a low turnover rate (10%), and low costs (0.34%) compared to other actively managed large-cap growth mutual funds[5].

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[3] https://advisors.vanguard.com/VGApp/iip/advisorsec/csa/literatureforms/fundsEtfs?litId=W2164&fundId=0559&rm_attr=on
[4] Morningstar.com
[5] Morningstar.com