Nicholas Hitting Stride After 45 Years at Fund: Riskless Return
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By Charles Stein

May 14 (Bloomberg) -- After 45 years of running the same mutual fund, Albert Nicholas is finally getting the hang of it.

Nicholas, 83, who has weathered downturns from the 1970s bear market to the dot-com bust in the early 2000s, picked enough winners in his $2.7 billion Nicholas Fund to produce the best risk-adjusted results among large-company growth funds over the past three years. The fund combined the highest total return and below-average volatility in a group of 82 comparable funds with at least $1 billion in assets, according to the BLOOMBERG RISKLESS RETURN RANKING.

Nicholas employs an investment philosophy that he developed four decades ago after a reliance on stocks of fast-growing companies crushed the fund when the U.S. stock market lost almost half of its value in a 21-month period from 1973 to 1974.

His approach includes an emphasis on risk management and paying reasonable prices for companies that can hold up in market downturns.

“We are still looking for growth, but our first rule is: try to avoid losing money,” Nicholas said in a telephone interview from Milwaukee.

Nicholas, who goes by “Ab,” has run the fund continuously since July 1969, a longevity streak topped by only two managers currently running U.S. mutual funds, according to Chicago-based Morningstar Inc. Ernest Monrad has been a manager on the $675 million Northeast Investors Trust, a high-yield bond fund, since 1960. Rupert H. Johnson Jr. has helped run the $2.1 billion Franklin Dynatech Fund since 1968, the data show.

Beating Markets

Over its lifetime, Nicholas’s fund has returned 11 percent a year, compared with a 10 percent gain for the Standard & Poor’s 500 Index, including reinvested dividends. That 1 percentage point difference adds up. A $10,000 investment in the Nicholas Fund when it started was worth about $1.2 million as of March 31, according to the firm. The same investment in the benchmark index would have produced $763,000.

“The record speaks for itself,” said Ted Kellner, executive chairman of Fiduciary Management Inc., one of a number of Milwaukee money-management firms that traces its roots back to Nicholas Co. Inc.

Nicholas Fund gained a risk-adjusted 3.3 percent in the three years ended May 12. It had a volatility of 18.4 compared with the average of 19.6 for the 82 funds, which excluded funds that invest in single industries such as health care.

Bloomberg's risk-adjusted return is calculated by dividing total return by volatility, or the degree of daily price-swing variation, giving a measure of income per unit risk. The returns aren't annualized.

American Century

The $2 billion American Century Income & Growth Fund ranked second, with above-average returns and below-average volatility.
The $3.2 billion American Century Equity Growth Fund ranked third with similar results.

As a star basketball player for the University of Wisconsin in the early 1950s, Nicholas was influenced by a finance professor named Frank Graner, who inspired him to become a stock-picking money manager. After stints at an insurance company and a bank, Nicholas opened his own firm in 1967 and the fund two years later.

In the early years, the fund's aggressive approach emphasized stocks of rapidly growing companies, which worked when the market was rising. In 1971, the fund returned 86 percent as the Standard & Poor's 500 Index rose 14 percent.

"But we were taking far too much risk," said Nicholas.

'Bad Numbers'

The S&P 500 fell 48 percent between January 1973 and October 1974. In the two years ended Dec. 31, 1974, Nicholas Fund lost 68 percent of its value, the firm's records show.

"When you lose 75 percent of your investment, you need a 300 percent gain to get back to where you started. Those are bad numbers," said Nicholas.

Out of the disaster came a renewed emphasis on managing risk and a focus on finding companies not heavily dependent on the economy for growth. Nicholas favors companies that have some unique competitive advantage, and prefers to buy them when they are out of favor. Like Warren Buffett, he generally avoids technology stocks because they are hard to understand.

The fund's unwillingness to buy tech hurt its performance in the late 1990s. When tech stocks fell in 2000 and 2001 Nicholas decided they were so cheap he bent his own rules and bought them, only to watch them fall further.

"We screwed up," he said. "We suffered because we didn't stay with our approach."

Asset Decline

Nicholas Fund fell 11 percent in 2001, and 22 percent in 2002, according to data compiled by Bloomberg. The poor performance triggered redemptions that cut the fund's assets to
$1.2 billion at the end of 2008 from $6 billion in 1998.

Since the end of 2007, the fund has returned about 12 percent a year compared with 7 percent for the S&P 500 Index.
Nicholas Fund lost 32 percent in 2008, better than the 37 percent decline in the benchmark index, and ahead of 93 percent of rival funds.

One of the stocks that has fueled the comeback is Affiliated Managers Group Inc., a Beverly, Massachusetts-based company that buys boutique asset-management firms. AMG, the second-largest position in the fund as of Dec. 31, gained 86 percent over the past three years.

"We've made a ton of money there," said Nicholas, who praised AMG for its acquisition strategy, which allows money managers at the smaller firms to retain an ownership interest in their business and an incentive to continue to perform well.

Valeant Holding

The fund's biggest holding, another serial acquirer, has done even better. Valeant Pharmaceuticals International Inc. has more than doubled over three years as the Laval, Quebec-based firm grew by scooping up other drugmakers.

Last month Valeant offered $45.7 billion in cash and stock to acquire Irvine, California-based Allergan Inc., the maker of Botox treatment. On May 12, Allergan rejected Valeant's unsolicited takeover proposal.

"We are getting a bit nervous," Nicholas said about Valeant. "That is an awfully big merger to try and pull off."

While he pays close attention to valuation, Nicholas will not automatically sell a stock just because it appears expensive. He has hung on to O'Reilly Automotive Inc., a longtime holding, even as the price-to-earnings ratio of the Springfield, Missouri-based retailer has climbed to almost 24 from about 19 at the end of 2012, according to data compiled by Bloomberg.

"We would not rush out to buy it today," he said, "but with great companies like this one we can live with some overvaluation for a while. We are not smart enough or quick enough to wait for it to get cheaper to buy again." O'Reilly has more than doubled in the last three years.

Gilead, LKQ

When a stock Nicholas likes dips in price, he will buy more. He added shares of Foster City, California-based Gilead Sciences Inc. when the price fell earlier in the year, part of a broad selloff in biotechnology stocks.

He added to his stake in LKQ Corp., a Chicago-based auto- parts repair service, after the stock tumbled in January following a report from short-seller Presience Point Research Group that accused LKQ of exaggerating its revenue growth. The company disputed the claim. Nicholas called LKQ, whose shares more doubled over three years, a unique business with strong prospects.

Nicholas has shared his success with his alma mater, the University of Wisconsin. He pledged $10 million to build the Kohl Center, a basketball and hockey arena on the Madison campus. In 2012, he donated $50 million for a program that will provide scholarships to high school basketball players, girls and boys, who attend one of the schools within the University of Wisconsin system.

'Competitive Guy'

William Nasgovitz, chairman of Heartland Advisors Inc., another Milwaukee asset-management firm, recalls that Nicholas was a regular participant in pickup basketball games in the city for decades after his playing days ended at Wisconsin. “Ab is a very competitive guy,” said Nasgovitz.

Nicholas, who has given up basketball for golf, doesn’t disagree.

“I love to compete,” he said. “That’s the best part of this business -- to see if we can beat the other guys.”

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