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COVER STORY

The New Activist Manager

Mutual funds are taking a page from hedge funds and engaging with the companies they invest in. It's about time.

By Leslie P. Norton

Time was, all you knew about your fund manager was the smiling photo that accompanied the bromides in your shareholder letter.

That gave way to a phalanx of star managers, many of whom seemed to spend more time on television than they did researching companies. Some spectacular flameouts—triggered first by the technology crash of 2000 and then the financial crisis of 2008—put an end to that and dealt a serious blow to active management. Investors began pouring money into passive funds. Active managers—especially those who did little more than mimic the index with a little window dressing—found themselves underperforming and unable to justify their higher fees. Now, the best active managers are getting energized. For many, that means turning "active" into activism.

Increasingly, fund managers are publicly expressing dissatisfaction with company management, a stance formerly reserved for activist investors such as Carl Icahn, Nelson Peltz, and Bill Ackman. But that's not all they're doing—they're also engaging in less-public interventions.

In the past, fund managers simply sold a stock if they didn't like what a company was doing. Today, more and more are nudging companies whose shares are trading far less than they should be to make changes that will close the valuation gap. Why ghost a company when you can help it become the investment you need it to be? These new voices are being heard: Whether they shout or they whisper, the market listens.

Consider Wellington Management, the venerated, press-shy $1 trillion firm that, for the first time ever, has publicly opposed management. In late February, Wellington, which runs $359 billion for Vanguard, announced it would oppose Bristol-Myers Squibb's (ticker: BMY) plan to acquire Celgene (CELG). Celgene shares fell 8% in a matter of hours.

Wellington's protest coincided with a behind-the-scenes critique by Dodge & Cox, another old-school money-management firm with $300 billion in assets. In every story about the Celgene deal, Dodge & Cox was described as a detractor.

"If I were asked to rank the most important moments of this era and name the one event that figures to have the most lasting impact, I would save the top spot for Wellington and its decision to become a public shareholder activist," says Don Bilson, head of event-driven research at Gordon Haskett. "Corporate America had better take note, because the folks who actually pick stocks have finally decided to flex their muscles."

"I have a pulpit. We owned Arris for 20 years before we engaged them. If you own a company for 20 years, are you a bully?"

–Benjamin Nahum, Neuberger Berman

Most fund managers aren't publicly embracing this role. Wellington declined to comment to Barron's. Dodge & Cox declined to comment beyond a statement saying: "We are active, long-term investors—not activists. Our approach is grounded in our commitment to advocating for what is in the best interest of our clients over the long term."

Activism, it seems, has a public relations problem. There's a wide spectrum of engagement with companies, including informal chats with executives as a way of testing and developing an investment thesis, making suggestions about capital allocation, and proxy voting. At the bleeding edge of the spectrum are activists: hedge fund firms such as Elliott Management, led by billionaire Paul Singer, Peltz's Trian Partners, and Ackman's Pershing Square.

These investors target companies with laggard stock prices, shrinking profit margins or revenue growth, and, often, large cash balances. They typically buy more than 5% of the company's shares outstanding, requiring them to file a 13D form with the Securities and Exchange Commission, serving notice to the company and the public that they are stakeholders of note.

These activists then begin suggesting fixes for underperformance; their recommendations often involve selling all or part of a company, unseating management, or proposing a new slate of directors. Much, though not all of this sort of activism is for short-term gain, and is expected to bear

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fruit within a year or so. It isn't necessarily focused on the long-term health of the company. For example, Icahn announced a large stake in Apple (AAPL) in August 2013, went on to write 37 Apple-related tweets and six open letters saying that Apple should do huge stock buybacks, and dined with Apple CEO Tim Cook. In the 2½years through the end of March 2016, Apple bought back 1.1 billion shares, and its stock price rose 60%—at which point Icahn had dumped all of his Apple shares.

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The number of companies targeted in 2018, versus 188 in 2017, according to Lazard.

Such an aggressive posture doesn't sit well with most mutual-fund managers, who regard themselves as fiduciaries for long-term, retirement-oriented investors.

That's a large part of why mutual-fund investors eschew the term activist and decline to talk about this sort of work on the record. For example, T. Rowe Price (TROW) officially states: "We do not believe it is T. Rowe Price's role to initiate activism campaigns." However, when the firm has a "significant" position in a company targeted by other activist investors, "it is our duty as engaged investors to participate in the process in the interest of reaching the outcome we conclude will produce the best result for our clients."

Still, more and more firms are privately acknowledging they are making a more activist effort—the preferred term is "engagement"—and doing so behind the scenes. The distinctions they would like to make about their brand of activism are that it's coming from a collegial, rather than combative place; it's focused on best practices for governance; and that they will be investors for the long haul.

Last year marked a landslide in activist deals. According to data from Lazard, a record $65 billion in capital was committed to activist campaigns in 2018, up from $62.4 billion the previous year. Some 226 companies were targeted in 2018, versus 188 in 2017. So-called traditional active managers are "increasingly comfortable sharing their views on major activist campaigns in private interactions with management and more public forums," Lazard noted.

These included T. Rowe Price, which said in December that it continued to support Nestlé's (NSRGY) board and management as activist Third Point pushed for the food giant to sell its stake in L'Oréal and boost growth; ClearBridge Investments, a unit of Legg Mason (LM); and publicly traded Janus Henderson (JHG), which pushed Athenahealth (ATHN) to consider selling itself after activist Elliott Management offered to buy the company. Then there was Artisan Partners (APAM), which criticized ABB's plan to spin off its power-grids operation.

Neuberger Berman has taken a more aggressive stance than other mutual-fund managers, advising on capital allocation and running several activist campaigns over the years. Neuberger president Joe Amato tells Barron's: "We act like an owner."

Still, the Neuberger version of active engagement "is different from the typical definition of activist," he adds. "If we have owned a stock for a reasonably long period, and for whatever reason they're running off the rails—governance, succession planning—we talk face to face. If we're unsatisfied, we write a letter to the board. We view something more public as a last resort."

"Crossing the Rubicon is the willingness to go public and go confrontational," says Benjamin Nahum, manager of Neuberger Berman Intrinsic Value fund, who has proposed directors and mounted proxy fights at about a dozen companies over the past decade. Last year, Neuberger, led by Nahum, urged set-top box provider Arris International to tie executive compensation to plans for capital allocation and acquisitions. Arris adopted the reforms, then agreed to be acquired by CommScope. Nahum says: "I have a pulpit. We owned Arris for 20 years before we engaged them. If you own a company for 20 years, are you a bully?" Nahum says his activism produces "something like 100 to 200 basis points [one or two percentage points] of excess return over the next one to three years" after the campaign gets under way.

$65 billion

The record amount of money committed to activist campaigns in 2018, according to Lazard.

Nahum's colleague Charles Kantor, manager of Neuberger Berman Long Short fund, has sided with specialty chemicals company Ashland Global (ASH) in its fight with activist hedge fund Cruiser Capital, which had proposed its own slate of directors. In exchange for his support, Ashland agreed to find and add two new directors and freshen up its board.

Other companies prefer a more decorous approach. Asked if a fund should make its proposals to a company public, AllianceBernstein (AB) chief investment officer Sharon Fay says: "No. When an activist [then] goes in and talks to a company, the company lawyers up. The dialogue shuts down." Indeed, companies can spend $10 million to $20 million fighting the demands of activists, according to McKinsey.

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The number of so-called "engagement investors," which are "typically but not exclusively mutual funds," that made demands at companies in 2018, according to Activist Insight

In a widely read piece called "The Megaphone Effect," Fay argues that active managers "can help promote important changes in corporate behavior and help enhance shareholder returns." Predictably, AllianceBernstein's list of engagement "wins" doesn't identify companies by name.

It's a trend that Fay calls constructivism: "It doesn't mean [presenting] an 80-page document about the different ways management has screwed up the company." It often follows an extended period of underperformance. The implication is that the fund manager who supports these reforms will be around in the years to come.

Active managers "have approached us recently with constructivist opportunities—the ability to engage management to act in a more shareholder-friendly manner. Our goal is never to embarrass anyone but rather to work with them," says Keith Rosenbloom, managing member of Cruiser Capital.

AllianceBernstein has started an internal research collaboration tool that tracks and documents engagements. Under incubation, too, is a fund called AB Concentrated Engagement, which made its first investments last fall in smaller companies "where there's a greater opportunity to identify misvaluation and help management close that gap," says Fay.

Fay sees it appealing to institutions and family offices. The fund will tap the expertise of Ali Dibadj, the top-ranked Bernstein Research analyst perhaps best known for telling giant Procter & Gamble to break itself up.

Investors may be scratching their heads—

isn't this, after all, what you pay your mutual-fund manager to do, i.e. represent your interests and produce returns that one hopes will beat the benchmarks? Well, yes. Southeastern Asset Management, which runs the Longleaf Funds, has engaged in activism since the 1990s. Ross Glotzbach, Southeastern's chief executive, says he wants to see "more than a few examples" of companies "engaging in less high-profile cases, when there's more behind the scenes work—for example, when they start filing a few 13Ds every year," before declaring this an impressive new trend. Otherwise, he says, "is that really being engaged? It's just doing your job."

That's fair. Mutual fund activism, after all, is a trend that's two decades in the making—a result of market and regulatory changes, an increase in investor education, and years of being trounced by index funds. Active managers have been facing more challenges, and most of the changes they've been forced to make have benefited investors. Hopefully, activism will continue this trend.

"On the whole, I think it's a positive for investors, but there are concerns," says Don Phillips, president of Investment Research at Morningstar. "Fund managers would be finally fulfilling their potential to amplify the voice of the small investor to Corporate America. By uniting many investor voices, these managers can speak more loudly than any of us could on our own. That's a benefit of fund investing that has been under-deployed to date, and may be a way for active managers to better earn their fees."

For many, this is a different way of doing business. But the landscape is changing. Big-name activists are getting airtime with traditional mutual-fund managers by joining mainstream industry organizations that help set standards for corporate governance, such as the Investor Stewardship Group and the Council of Institutional Investors Corporate Governance Advisory Council. "They're socializing before and after the meetings, getting more touches with the funds, and getting a lot more time to develop a rapport that thousands of public companies aren't getting," one banker says.

That softer approach is also more likely to win the support of index investors, which aren't interested in capital allocation but want companies to be sustainable over the long term. After all, BlackRock CEO Larry Fink has criticized short-term activists. "What's changed over time is the refinement of any activist's approach," says Glenn Booraem, head of investment stewardship at Vanguard Group. "Many activists are showing up with a better slate of directors. That's going to earn them more support from the mainstream." Index investors are pushing companies to improve performance on environmental, social, and governance factors, which they regard as programs to reduce shareholder risk over the long haul.

But does activism work over the long haul? So far, the data isn't conclusive. According to data from Activist Insight, 62 so-called "engagement investors," which are "typically but not exclusively mutual funds," made demands at companies in 2018. That's up from 42 in 2014, but down from 81 in 2017.

That doesn't mean they haven't stepped up their interactions with companies. "Engagement is difficult to measure," says Jackie Cook, director of sustainable stewardship research at Morningstar and founder of Morningstar's FundVotes proxy research unit.

Large investment firms produce engagement reports that give a sense of the issues they're addressing and how many companies, but not a list of names or the kind of progress they're making.

Consider the big kahunas of active management: Fidelity Investments and Capital Group, parent of American funds. Morningstar's Cook looked at 3.5 million votes on director elections and "say on pay" resolutions, where shareholders vote on manager compensation. Over the past several years, both Fidelity and American stepped up their votes supporting governance measures proposed by shareholders, but also tended to vote with management on director elections and say on pay. Fidelity and Capital declined to comment.

Activism should be thoughtful—it isn't always about battling management. Even so, "not every investment ends positively. That's life," says Southeastern's Glotzbach. "But there's more upside than downside to people thinking like owners and actual partners in a business." ■

How to Be a Good Activist Investor

"Keep it long-term. Have reasonable suggestions. Stay in your circle of competence," says Ross Glotzbach, CEO of Southeastern Asset Management, which runs Longleaf Funds. Glotzbach and his colleagues like to share their expertise on capital allocation. Recently, for example, Southeastern switched its filing on fiber provider CenturyLink (CTL), a long-term holding, to a more activist 13D from a 13G in order to "have more direct conversations" about adding directors to the board. "The [recent] dividend cut was not the best way to address balance sheet concerns," the filing says, so the firm "will seek to add directors who not only bring fiber and network expertise, but who also have deep financial expertise."

Have intestinal fortitude. You will get huge amounts of blowback from companies, which are known to spend $10 million to $20 million fighting the demands of activists, according to McKinsey. When Neuberger Berman's Benjamin Nahum waged a proxy fight at chip-equipment manufacturer Ultratech in 2015, Nahum's nominee directors were criticized, as was his fund's performance. Two years later, Ultratech agreed to be acquired by Veeco Instruments.

The right personality to run a hearts and minds campaign helps. "You need to have a defined skillset, be persuasive, have conviction and the personality to stand in front of a room of successful board members and persuade them. A lot of really smart active value guys don't have those skills" says Kenneth Squire, founder of 13D Monitor and manager of the 13D Activist Fund (DDDAX). L.P.N.

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An investor should consider a Fund's investment objectives, risks and fees and expenses carefully before investing. This and other important information can be found in each Fund's prospectus and summary prospectus, which you can obtain by calling 877.628.2583. Please read the prospectus and summary prospectus carefully before making an investment. Investments could result in loss of principal.

Risks for Neuberger Berman Intrinsic Value Fund

Investing in companies in anticipation of a catalyst carries the risk that the catalyst may not happen as anticipated, possibly due to the actions of other market participants, or the market may react to the catalyst differently than expected.

A decline in the Fund's average net assets during the current fiscal year due to market volatility or other factors could cause the Fund's expenses for the current fiscal year to be higher than the expense information presented.

An individual security may be more volatile, and may perform differently, than the market as a whole.

Markets may be volatile and values of individual securities and other investments, including those of a particular type, may decline significantly in response to adverse issuer, political, regulatory, market, economic or other developments that may cause broad changes in market value, public perceptions concerning these developments, and adverse investor sentiment or publicity.

At times, small- and mid-cap companies may be out of favor with investors. Compared to larger companies, small- and mid-cap companies may depend on a more limited management group, may have a shorter history of operations, and may have limited product lines, markets or financial resources. The securities of small- and mid-cap companies are often more volatile and less liquid than the securities of larger companies and may be more affected than other types of securities by the underperformance of a sector or during market downturns.

The Fund and its service providers, and your ability to transact with the Fund, may be negatively impacted due to operational matters arising from, among other problems, human errors, systems and technology disruptions or failures, or cybersecurity incidents. Most issuers in which the Fund invests are heavily dependent on computers for data storage and operations, and require ready access to the internet to conduct their business.

Some countries, including the U.S., are considering the adoption of more protectionist trade policies, moving away from the tighter financial industry regulations that followed the 2008 financial crisis.

The Fund may experience periods of heavy redemptions that could cause the Fund to sell assets at inopportune times or at a loss or depressed value. Redemption risk is heightened during periods of declining or illiquid markets.

Risk is an essential part of investing. No risk management program can eliminate the Fund's exposure to adverse events; at best, it may only reduce the possibility that the Fund will be affected by such events, and especially those risks that are not intrinsic to the Fund's investment program.

From time to time, based on market or economic conditions, the Fund may have significant positions in one or more sectors of the market. To the extent the Fund invests more heavily in particular sectors, its performance will be especially sensitive to developments that significantly affect those sectors.

The Fund may not be able to sell an investment at the price at which the Fund has valued the investment.

Value stocks may remain undervalued or may decrease in value during a given period or may not ever realize what the portfolio management team believes to be their full value or intrinsic value.

Risks for Neuberger Berman Long Short Fund

Small- and mid-capitalization stocks are more vulnerable to financial risks and other risks than stocks of larger companies. They also trade less frequently and in lower volume than larger company stocks, so their market prices tend to be more volatile. Large-cap stocks are subject to all the risks of stock market investing, including the risk that they may lose value.

Short sales involve selling a security the Fund does not own in anticipation that the security's price will decline. Short sales may help hedge against general market risk to the securities held in the portfolio but theoretically present unlimited risk on an individual stock basis, since the Fund may be required to buy the security sold short at a time when the security has appreciated in value. The Fund may not always be able to close out a short position at a favorable time and price. If the Fund covers its short sale at an unfavorable price, the cover transaction is likely to reduce or eliminate any gain, or cause a loss to the Fund, as a result of the short sale.

There is no guarantee that the use of long and short positions will succeed in limiting the Fund's exposure to market movements, sector-swings or other risk factors.

Investing in foreign securities may involve greater risks than investing in securities of U.S. issuers, such as currency fluctuations, potential social, political or economic instability, restrictions on foreign investors, less stringent regulation and less market liquidity. Securities issued in emerging market countries may be more volatile and less liquid than securities issued in foreign countries with more developed economies or markets as such governments may be less stable and more likely to impose capital controls as well as impose additional taxes and liquidity restrictions.

Exchange rate exposure and currency fluctuations could erase or augment investment results. The Fund may hedge currency risks when available though the hedging instruments may not always perform as expected. Derivatives contracts on non-U.S. currencies are subject to exchange rate movements.

Shares in the Fund may fluctuate based on interest rates, market condition, credit quality and other factors. In a rising interest rate environment, the value of the Fund's fixed-income investments is likely to fall.

Use of derivatives is a highly specialized activity that can involve investment techniques and risks different from, and in some respects greater than, those associated with more traditional investments. Derivatives can be highly complex, can create leverage, may be highly volatile and the Fund could lose more than the amount it invests. Derivatives may at times be highly illiquid, and the Fund may not be able to close out or sell a derivative at a particular time or at an anticipated price. Derivatives can be difficult to value. There may be imperfect correlation between the behavior of a derivative and that of the reference instrument underlying the derivative. Derivatives involve counterparty risk, which is the risk that the other party to the derivative will fail to make required payments or otherwise comply with the terms of the derivative.

Derivative instruments and short sales may also have an effect similar to that of leverage and can result in losses to the Fund that exceed the amount originally invested in the derivative instruments. Leverage may amplify changes in the Fund's net asset value ("NAV").

ETFs are subject to tracking error and may be unable to sell poorly performing stocks that are included in their index. ETFs may trade in the secondary market at prices below the value of their underlying portfolios and may not be liquid. Through its investment in exchange traded funds, the Fund is subject to the risks of the ETF's investments, as well as to the ETF's expenses.

For the companies mentioned in the article, the percent holdings as of 3/31/19 in the Neuberger Berman Intrinsic Value Fund are: Arris International: 0%, CommScope: 0%, Ultratech: 0%, Veeco Instruments: 0.9%. The percent holding as of 3/31/19 of Ashland in the Neuberger Berman Long Short Fund is 2.1%.