AMG River Road Dividend All Cap Value N ARDEX

This strategy focuses on yield, but its risk-adjusted results are more compelling.

Morningstar's Take ARDEX

Morningstar Rating	★★
Morningstar Analyst Rating	Bronze

Morningstar Pillars

Process	Above Average
Performance	—
People	Above Average
Parent	Average
Price	—

Role In Portfolio
Supporting Player

Fund Performance

Year	Total Return (%)	+/- Category
YTD	-14.76	-2.25
2019	23.14	-1.90
2018	-7.65	0.89
2017	8.78	-7.16
2016	20.19	5.38

Data through 10-31-20

11-04-20 | by Kevin McDevitt

AMG River Road Dividend All-Cap Value's income orientation helps keep its volatility below benchmark. The strategy retains its Morningstar Analyst Rating of Bronze.

This is an income-oriented dividend strategy. That may sound like a truism, but this emphasis distinguishes it from many strategies that buy dividend-paying companies more as a quality screen rather than for yield. By contrast, this strategy aims for a pre-expense yield that's 150% of the Russell 3000 Value Index's. The October 2019 portfolio's projected 3.9% yield would just about hit that target. To get there, the management team looks for core stocks (with yields of 2%-4%), what it deems "high alpha" (3%-6% yields), and high-yield (greater than 5% yields). The high-yield segment claimed 23.3% of the September 2019 portfolio, in management's estimation. It tends to include traditional high-yield stocks like REITs and energy pipeline companies. But it also includes amusement-park operators Six Flags Entertainment SIX and Cedar Fair FUN.

Such a large high-yield stake certainly carries risk, but it's balanced in several ways. Most importantly, the management team is very risk-aware. One of its stated aims is to keep long-term volatility below that of the benchmark. It has been successful in this regard, limiting downside capture to just 75% of the index's since the strategy's inception. Sticking to dividend-paying stocks has helped smooth out some of the inevitable bumps in the road. The team also keeps tabs on overall market risk and this work informs the allocations among its three buckets. The heightened market volatility over the last 12 or so months led the team to increase the weighting in core stocks to 60.6% as of September; this is well above the typical 50% upper bound. Allocations to high-alpha (16.1%) and high-yield stocks were both a bit below their typical lower bounds.

This attention to downside risk is ultimately the strategy's best attribute. While returns have lagged the benchmark over the trailing 10 years, the strategy has fared better on a risk-adjusted basis.

Process Pillar Above Average | Kevin McDevitt 11/26/2019
This fund's defense-minded, all-cap strategy merits an Above Average Process rating.

The managers describe their approach as absolute value, which falls between low-quality deep value and "growthier" relative-value strategies. They stick to dividend-paying companies with market caps of more than $300 million and aim to generate a yield that's 150% of the index's before fees. Yet, they keep the portfolio diversified and their disciplined approach has led to outperformance during down markets.

The managers aim to beat the Russell 3000 Value Index by investing in a mix of core large-caps with 2%-4% yields, "high alpha" stocks with 3%-6% yields, and high-yielding stocks (5%-plus yield). The managers go where they find the best opportunities, which often leads to a third or so of the portfolio in small- and mid-cap stocks. They favor firms with strong business models and solid balance sheets with shares trading at a minimum 15% discount to their price target (or 10% for high-yielding stocks). They value most firms based on enterprise value relative to projected EBITDA during the next 12-18 months.

The managers protect against value traps by not adding to a position if its share price has fallen. They sell if they become concerned about a firm's ability or willingness to grow its dividend. They review stocks that hit their price targets, trim those trading at a 10% premium, and sell before they reach a 20% premium.

Management builds an all-cap portfolio of roughly 60-80 stocks. The portfolio tends toward the lower end of that range when overall market valuations are rich and the higher end when bargains abound. Top positions generally take up about 3% of assets, with a 5% cap to control security-specific risk, while smaller positions occupy around 0.5%. A combination of yield, estimated share price discount, and conviction determines each position size. Liquidity figures in, too. The managers take smaller position sizes in more thinly traded stocks at the lower end of the market-cap spectrum. In October 2019, 31.8% of the fund's assets were in mid-, small- and micro-cap stocks combined versus 28.4% for the Russell 3000 Value Index.

Company-level, bottom-up analysis has the greatest impact on sector positioning. These days, the fund treads lightly in financials and healthcare and heavily in energy, industrials, and real estate. Sector bets can be sizable, although the fund will not invest more than 30% of assets in any one sector.

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Performance Pillar | Kevin McDevitt 11/26/2019
This fund often lags during rallies but tends to hold up well in challenging market conditions. Since Thomas Forsha joined with lead manager Henry Sanders in June 2007, the fund captured just 75% of the downside results of the Russell 3000 Value Index through October 2019. That's thanks to its dividend-focused strategy and downside protection measures, which include not adding to positions in firms whose share prices have plummeted and forced trimming of positions whenever net unrealized losses in the overall portfolio begin to multiply. Both measures kept the fund from falling as far as its benchmark during the 2007-09 credit crisis. The managers started trimming financials in early 2008, and the fund's 47.7% peak-to-trough cumulative loss was 12.1 percentage points less than the Russell 3000 Value Index.

During Forsha and Sanders' combined tenure, the fund's 6.7% annualized gain through October 2019 beat the Russell 3000 Value Index by 75 basis points. Plus, the fund was less volatile than the index, with a standard deviation of 12.7 versus the index's 15.8. As a result, the fund's 0.47 Sharpe ratio was much better than the index's 0.33 during this stretch.

The fund tends to fare worse during rallies, claiming just 83.5% of the index's upside. But this trade-off has been more than worthwhile given the fund's overall results, especially on a risk-adjusted basis.

People Pillar Above Average | Kevin McDevitt 11/26/2019
Experience, stability, and fund ownership characterize this strategy's management team, earning it an Above Average People rating. Lead portfolio manager Henry Sanders began running this strategy as a separate account in October 2003 while at Commonwealth SMC. He co-founded River Road in 2005 and launched the retail share class of this fund in June of that year. Thomas Forsha has comanaged the fund since June 2007. He joined River Road in July 2005 after working as an equity analyst and managing a similar dividend-focused strategy for ABN AMRO. The newest member of the team, Andrew McIntosh, became an associate portfolio manager in 2018. He has been with the firm for eight years and has 15 years of industry experience. James Shircliff, River Road's CIO, is a listed comanager but is not involved on a daily basis.

River Road has historically had success with its analyst team, retaining 10 of 13 analysts hired since 2005. Two of the three who left, however, were dedicated to this strategy. Erik Keener departed in April 2016 to take a job outside the investment industry, and two weeks later John Watkins left for a portfolio management job at another firm. The fund is currently supported by seven generalist analysts, whose industry experience ranges from two to 22 years. Alan Harris joined to take McIntosh's spot on the analyst team in November 2018. The team plans to hire another analyst next year.

Parent Pillar Average | Linda Abu Mushrefova 11/04/2020
AMG Funds has some strong affiliates, but a lack of consistency in its offerings and recent lineup changes damp conviction. It maintains an Average Parent rating.

While AMG's stronger affiliates have held up relatively well, net outflows have caused the firm and its affiliates to liquidate or merge subscale offerings, including AMG GW&K US Small Cap Growth and AMG River Road Dividend All Cap Value. In another instance, affiliate Chicago Equity Partners shuttered its business entirely, spurring a subadvisor and name change on AMG GW&K Global Allocation. Recent challenges in AMG's quantitative offerings have contributed most substantially to outflows, with shops such as AQR suffering the most.

Historically, AMG has grown by acquisition, but the firm has seen a dry spell in new partnerships, and it has thus recently closed far more offerings than it has introduced. Leadership at the firm plans to change that, though, and it has made some smaller investments more recently. It acquired a minority equity interest in Comvest Partners, a middle-market private equity and credit investment firm, in 2020. It also made an investment in startup Inclusive Capital Partners (a firm with an environmental, social, and governance focus), founded by ValueAct (another affiliate) founder Jeff Ubben. AMG's recent investments reflect its continued focus on alternative strategies and newer emphasis on ESG.

Price Pillar | Kevin McDevitt 11/26/2019
It's critical to evaluate expenses, as they come directly out of returns. The share class on this report levies a fee that ranks in its Morningstar category's second-costliest quintile. That's poor, but based on our assessment of the fund's People, Process and Parent pillars in the context of these fees, we still think this share class will be able to overcome its high fees and deliver positive alpha relative to the category benchmark index, explaining its Morningstar Analyst Rating of Bronze.