

FUND COMMENTARY

A skeptic's eye helps drive performance for Thrivent Mid Cap Value Fund

By Gene Walden, Senior Finance Editor | 03/28/2023



Question everything.

That philosophy helped Graham Wong guide Thrivent Mid Cap Value Fund (**TMCVX**) through the ups and downs of the past three years since the Fund's inception in March 2020 – just as COVID-19 was set to explode across the globe.

The Fund received a 5-Star Overall Morningstar™ Rating out of 386 Mid-Cap Value funds period ending February 28, 2023, based on risk-adjusted performance.

Wong's search for truth has evolved from years of witnessing overzealous projections, errant consensus opinions, and outright corporate fraud. He entered the investment industry at the height of the Dot-Com crash of the early 2000's when Enron and WorldCom both collapsed like a house of cards. "I'm naturally optimistic," said Wong, "and I want to believe that people are honest, but going through the Dot-Com era made me really understand that management can lie, and that we really have to roll up our sleeves and do our own analysis."

That sense of skepticism was reinforced during the Great Financial Crisis of 2008-09 when some other venerable Wall Street institutions, like Lehman Brothers and Bear Sterns, bit the dust. "There were a lot of people who didn't believe we had a crisis, who didn't believe the banks were going to

fail. There were people who thought Lehman would survive, and they bought it when it looked cheap before it went to zero. So, both of those experiences really taught me to be skeptical, to do our own independent analysis, and to be critical.”

Wong, a native of Hong Kong, says his drive to question everything was instilled by his mentor at his first job, Susan Byrne, the founder of Dallas-based Westwood Management. “She was one of the strongest out-of-the-box thinkers I've ever worked with,” said Wong, “and she taught me to always question consensus views.”

After coming to Thrivent in 2013, Wong worked with Thrivent Large Cap Value Fund Manager Kurt Lauber and Thrivent Head of Equities Matt Finn, who challenged him to push even harder on research and analysis. While Finn stressed the importance of risk management, Lauber encouraged him to maintain an impeccable investment process. “Kurt asked really tough questions, and always pushed me to dig deeper. The objective is to dig deep enough to find that nugget that gives us the conviction to buy the stock.”

A step ahead of the market

Thrivent Mid Cap Value Fund not only outperformed its benchmarks (Russell Mid Cap Value and the Morningstar Peer Group) each of the three years from 2020 through 2022 during the 2020 COVID-19 shutdown, but also during the 2021 bull market and the 2022 bear market. Wong credits the Fund’s performance to the flexibility that active management affords.

“Active management really allows us to concentrate our portfolio into our best ideas. And, unlike passive products, we don't have to own the bad companies; we only own our best ideas.” That flexibility is especially important for value investing. “Cyclical investing is a big part of value investing, so when we're at the trough, for instance, we're nimble enough to buy the companies that we believe will benefit from the recovery.”

In 2020, when the Fund was launched, the ultimate impact of COVID-19 was not yet on the radar, but Wong said economists had already been predicting a recession within two to three years.

“Given that we were in the tenth year of a long economic cycle, it just felt like the right thing to be a little bit more defensive and own late-cycle names. We really benefited from the sharp correction in March and April of 2020. Then at the bottom, we noticed that a lot of the cyclical companies were trading at excessive discounts, so we pivoted to those companies. As a result, we benefited on the way down, pivoted to more cyclical, early-cycle companies, and benefited again on the way up.”

During the early days of the pandemic, the Fund shied away from companies like airlines and hotels that would likely be severely affected by the shutdown. But Wong had to take some calculated risks to find the adversely affected companies that could bounce back the best. One of the Fund’s biggest winners was Sysco, a major food supplier for bars and restaurants.

“The question we asked ourselves was, ‘how long could restaurants be completely shut down before Sysco would face liquidity issues?’” recalled Wong. “After our analysis, the answer we came to was two-and-a half years. So, then our decision at the time was, ‘do we believe COVID is going to lead to restaurants being closed for more than two-and-a-half years?’ It’s an easy question to answer now in hindsight, but at the time, COVID was new, and we didn’t know, but we believed that that would *not* be the case. As a result, we bought the stock, and it was a fantastic winner for us.”

Rolling through the rollercoaster ride

“Value managers try to be non-consensus,” explains Wong. “We try to zig when the market zags.” In 2021, near the bottom of the market, Wong pivoted to stocks that the Fund team believed had been overly punished in the market downdraft. As a result, the Fund rallied during the bull market of 2021, outperforming in eight out of the 11 major sectors.

“It was the first year that value outperformed growth, and we particularly benefited in the Information Technology sector,” said Wong. The Fund had added some lesser-known tech names like Jabil, an electronic manufacturing service company. “They’re not the Teslas or the Apples of the world, but they make the iPhones, and they make certain components for Tesla. Jabil became a higher margin, high free cash flow generating company as the industry consolidated.”

In 2022, after tweaking the portfolio again, the Fund outperformed the market in nine out of 11 sectors. “The headwind in 2022 was obviously inflation,” recalled Wong, “so we made sure that we owned companies that had strong pricing power to deal with that environment.”

One example was Dollar Tree, which, as Wong termed it, “debucked,” raising prices from \$1.00 to \$1.25. “As a consumer, I don’t know if they notice it or not, but as an analyst, 25 cents is a 25% price increase. So, that’s fabulous pricing power for them in an inflationary environment.”

Another value pick was D.R. Horton, a homebuilder whose stock price nosedived as mortgage rates surged. The stock dropped to around one times valuation to its existing inventory. “What that means,” explained Wong, “is that the inventory was worth more than the entire company. You could sell it, pay off debt, and still have more money than the stock was worth. The actual business was being given away for free.”

The secret sauce

Wong insists there’s no persistent theme that guides his portfolio management process. “But if there is one, we like ‘boring.’ We don’t own headline stocks – that’s not our strength. We tend to avoid them because it’s a crowded area. Instead, we try to own high-quality companies that are neglected and undervalued.”

In shaping the portfolio, macro factors are less of a concern than stock selection. “We don't try to win by getting the macro picture right,” asserts Wong. “We frequently ask ourselves: ‘what inning of the market cycle are we in?’ And we tilt the portfolio accordingly. But we think of macro factors more from a risk management perspective. We're trying to neutralize factor risks and make sure we don't have any unintended bets. We really try to take all our risks in the stock selection bucket and win by picking stocks.”

Wong defines value as “undervalued companies with high or improving economic returns,” which he believes differentiates the Fund from other value managers who might be more interested in the price of the stock rather than the quality of the company. “We also tend to shy away from buying these high growth, high value highfliers because we're worried about what may happen if growth decelerates.

“In terms of market conditions, we are bottom-up stock pickers, and we don't make market calls. We strive to outperform regardless of whether the market goes up or down by rigorously vetting the companies we own.”

One example is Lamb Weston, which supplies the potatoes for McDonald's French fries. “We keep track of the potato crop because if they get the larger potatoes, that's where they can charge a premium price to make longer French fries. That's an example of the type of *boring* stocks that we like to own.”

Drilling deeper

The Fund looks for stocks with what Wong calls an “asymmetric reward/risk profile.” They start with the downside. “Can we quantify the downside and is it limited (to around 20% or less)? On the upside, we look for a multiple of the downside. Our asymmetric reward/risk ratio is about three times or more upside than downside.”

Wong may also consider history in determining when to buy or sell a stock. “We want to know where these stocks have traded to in a weak environment, or what's a good support level when they experience issues? Would that be based on something like their asset valuation or their cash flows? We run through multiple scenarios to figure out the downside, but it needs to be quantifiable. And the key there is that we use our own proprietary research and modeling, and we're not relying on consensus or sell side for that.”

The importance of working with an experienced research team is not lost on Wong. His Fund Co-Manager, Nick Griffith, holds Doctor of Medicine and MBA degrees, as well the Chartered Financial Analyst (CFA) designation. “His background obviously is very strong in Health Care, and he's already adding alpha there, helping to pick stocks,” said Wong. “He's also particularly strong in gathering and analyzing data for us.”

To stay in shape, Wong plays basketball in his off hours and also coaches his son's youth team. "I really appreciate the sport of basketball because it teaches you to be a team player." Those skills have translated into more success in the asset management world, as well, where Team Wong has navigated the ups and downs of a turbulent market to execute a winning strategy for the Fund.

Past performance is not necessarily indicative of future results.

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