

Forbes

INVESTING

THE 2019 INVESTMENT GUIDE MUTUAL FUNDS

Bear Beater

TODD AHLSTEN HAS A RECIPE FOR FINDING INVESTMENTS THAT HOLD UP WELL IN DOWN MARKETS. ONE OF THE INGREDIENTS IS CORPORATE VIRTUE.

BY WILLIAM BALDWIN



Todd Ahlsten's rainy-day stocks have lots of recurring revenue. Hologic and Danaher qualify on their income from medical diagnostics.

There are stocks for daredevils, and there are stocks for nail biters. You'll find the latter in the Parnassus Core Equity Fund.

Anyone who hasn't given much thought to risk just got an awakening. After a bull market stretching out not quite a decade, stocks, as measured by the Vanguard Total Stock Market Fund, retreated 19.6% in the

three months before Christmas. That may or may not be a foretaste of something much worse, but it's worth noting that, so far in this century, there have been two crashes that cut stocks in half.

Short of fleeing to cash, which delivers a meager return, what can a nervous investor do? Seek out shares that suffer less damage than most in bear markets. Todd Ahlsten,

lead manager of \$15 billion Parnassus Core Equity since 2002, has a knack for identifying those.

Forbes rates U.S. equity funds separately for bull- and bear-market performance across three market cycles going back 16 years. Only 7 of them (out of 974) have managed to deliver market-beating results over the full period while earning A+ grades in down markets.

Ahlsten's fund is one of those 7.

What's his recipe? Follow the rules and you will see why timid investors might like Linde and WD-40 but not Salesforce.com and U.S. Steel.

First, Ahlsten asks, "How sturdy is the top line?" This is more a matter of judgment than numbers. "We are not a quant house," he says. He wants to see predictable revenues. Linde, which sells industrial gases, gets them via contracts that have factories paying for a hook-up whether they use the gas or not. It also has steady income from bottled gases sold to restaurants and hospitals. He has owned that stock for a decade.

Xylem, which sells things like Bell & Gossett pumps, is a steady Eddie because homeowners and municipal waterworks buy replacement parts when they need them, whether or not a recession is under way. Danaher hauls in predictable revenue from the supplies used in its testing equipment. Software vendors (Microsoft and others) are in Ahlsten's portfolio because of their subscription revenue.

Next rule: Favor companies with low debt, usually no more than three times earnings before interest, tax and depreciation. Debt exaggerates gains in economic expansions but exaggerates damage in bad times.

The third thing is a matter of price. Five blocks from Ahlsten's 16th-floor office in San Francisco is the gleaming new tower occupied by Salesforce.com, which sells software that lets corporations track their products, customers and employees. "Fantastic company," he says, "but the valuation!" It goes for 156 times trailing earnings. High-multiple companies get killed in bear markets. He doesn't own any of that one.

Last on our list, but first in the thinking at Parnassus, is a matter of conscience. Companies producing alcohol, tobacco, weapons or nuclear power are unworthy. So are outfits that fail to treat the environment or employees with kid gloves.

The do-gooder angle goes back to the founding of the firm by Jerome Dodson. Dodson's first jobs after business school involved minority-owned businesses and solar energy. His next venture was a socially conscious money market fund. Alas, investors



are not inspired by fine distinctions between good and evil bankers' acceptances; after Dodson left, the money fund merged into a plain old Treasury fund.

But then Dodson hit pay dirt by applying social screens to stocks and, later, bonds. Parnassus Investments, which opened its doors in 1984 and has five funds, oversees \$25 billion.

Ahlsten joined Parnassus immediately after getting a diploma from Berkeley. His father was a pilot at TWA who experienced the tender mercies of corporate raider Carl Icahn. "I got to see the human toll of layoffs," Ahlsten says.

It is quite possible to do well by investing virtuously. Dodson, who stepped down from the chief executive slot last year at 74, and Ahlsten, 46, are the largest shareholders in Parnassus Investments. To judge from the value the stock market assigns to T. Rowe Price, Parnassus is maybe worth half a billion dollars.

What's in it for the individual investor? Owning clean-living companies "can help us avoid hidden risks," Ahlsten says. That's plausible. A software company isn't going to have a pipeline explosion. A generous employer isn't going to experience a strike.

Compare spray-lube vendor WD-40, in

which Parnassus Core Equity first invested in 1998, to U.S. Steel, which it wouldn't touch with a ten-foot pipe. Visits to WD-40's San Diego headquarters left Ahlsten with an impression of a benevolent workplace with a "cohesive culture" that promotes "innovation and intellectual curiosity."

Fuzzy talk? Let's look at some hard numbers. For its last fiscal year U.S. Steel, which has factory workers (unionized) on its payroll, has a gross profit per employee of \$47,500. WD-40, without that burden, has a comparable figure of \$469,000. WD-40 can afford to be a saintly employer; U.S. Steel can't.

This is what shareholders experience: WD-40 has a beta (per Value Line) of 0.8, which means that the lurches up and down of its shares tend to be 80% as great as the market's. Steel's beta is 1.9; its shares zoomed in 2016 but got killed in 2018.

You can make money with daredevil stocks. We give the Hodges Fund, which has a position in U.S. Steel, an A+ for up markets and an F for down. It has beaten the market over the past 16 years, despite rotten performance during the recent correction. Nail biters, though, should steer clear of A+/F funds. The Forbes bull and bear grades can be found at forbes.com/mutual-fund-ratings. **F**

(#S070022) Excerpted and adapted with permission of Forbes Media LLC © 2019. To subscribe, please visit Forbes.com or call (800) 888-9896. For more information about reprints and licensing, visit www.parsintl.com.

