Mutual Fund Outperforms Using 51-Year-Old Investment Strategy

DynaTech Fund Born In 1968

Fund seeks companies that exploit innovations, are led by top managers

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What makes a portfolio one of the best mutual funds? How about sticking with an investment strategy that wins long-term?

That's what Franklin DynaTech Fund (FKDNX) has done. This $9.5 billion fund still aims to make money the way it has since its 1968 inception.

“The philosophy behind this fund is that wealth creation in any economy occurs with innovators,” said Matthew Moberg, lead manager since 2009 and only the fund’s second manager overall. “And we've always felt that one way to outperform is to focus on innovative companies, or as we termed them in the beginning, dynamic technology companies.”

That appetite for innovators often leads Moberg and co-manager Rupert Johnson — who was the fund’s first manager — to look for opportunities among information technology stocks. With a 43% weighting, that group was the fund’s largest sector as of Sept. 30, according to the fund’s own sector breakdown.

Johnson was the fund’s first lead manager, starting Jan. 2, 1968.

Moberg and Johnson aim to keep this portfolio among the best mutual funds by stocking it with leaders in innovation. They search for companies that take advantage of new technologies, have superior management and benefit from new industry conditions in a dynamically changing global economy.

Basing themselves in a global epicenter of innovation helps. “For 51 years we’ve been investing here in Silicon Valley,” Moberg said. “Our entire history is in Silicon Valley.”

The fund’s focus on innovation has paid off. The fund earned a 2019 IBD Best Mutual Funds Award. The fund won that distinction by beating the S&P 500 in 2018 and topping the broad market benchmark over the three, five and 10 years ended last Dec. 31, on an average-annual-return basis.

Some recent newcomers to the portfolio illustrate how Moberg and Johnson think about innovators.

DynaTech began its current stake in RingCentral (RNG) in the third quarter. The company develops software that lets users communicate via voice, text and fax on multiple devices, including phones, tablets and personal computers. Earnings have grown at a 125% average annual pace the past three years, on top of 33% average annual sales growth.

“What RingCentral really is is a leader in Unified Communications as a Service (UCaaS), replacing legacy PBX phone systems with software,” Moberg said. UCaaS provides a cloud-based business communications system across multiple channels and devices. “They are moving unified communications into software-as-a-service (SaaS),” Moberg said.

He added, “The main differentiation that RingCentral has is that they attack the small- to medium-size business market, using a direct sales force.”

Gaining Share

Moberg says a direct sales force is expensive and difficult to build. “But once it’s up and running, it turns out to be a competitive advantage.” Especially, he adds, while UCaaS is gaining share from legacy PBX systems.

Moberg also likes a recent

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deal struck by RingCentral, allowing it to sell UCaaS services to Avaya Holdings’ (AVYA) large customer base. Steris (STE) was another Q3 new buy for DynaTech. The Ireland-based provider of infection prevention and surgical products has averaged 15% annual earnings growth the past three years. “They sell products to hospitals, which either on-site help you sterilize things like surgical equipment or off-site if the equipment is contaminated enough,” Moberg said. “You also need sterilization when you work with contract research organizations (CROs).” Moberg added, “Clearly, infections are an area where hospitals are becoming more dangerous, especially with drug-resistant infections.” A strong U.S. employment picture helps Steris by making workers more willing to spend on health care, Moberg says. Altogether, that explains Steris’ 7% to 11% organic sales growth over the past six quarters, Moberg says. “This makes Steris a stable health-care-type business.” Zoetis (ZTS) was another Q3 addition by the fund. Now Moberg and Johnson hope it will help the fund remain among the best mutual funds. Earnings for Zoetis grew 26% annually on average the past three years, on top of 9% average annual sales growth. The company develops medicines and vaccines for animals. Moberg said, “It’s gotten to the point that (the field) has insurance associated with it, because companion animals are considered part of the family now.” Also, Moberg likes Zoetis’ move into diagnostics and its expansion outside the U.S. “The company could be worth significantly more if it can execute outside the U.S. in the companion-animal space,” he said.

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Effective 5/15/08, the fund began offering Advisor Class shares. For periods prior to the fund’s Advisor Class inception date, a restated figure is used based on the fund’s oldest share class, Class A performance, excluding the effect of Class A’s maximum initial sales charge but reflecting the effect of the Class A Rule 12b-1 fees; and for periods after the fund’s Advisor Class inception date, actual Advisor Class performance is used, reflecting all charges and fees applicable to that class.

Class A. Prior to 9/10/18, these shares were offered at a higher initial sales charge of 5.75%; thus actual returns would have differed. Total returns with sales charges have been restated to reflect the current maximum initial sales charge of 5.50%. Effective 5/1/94, the fund implemented a Rule 12b-1 plan, which affects subsequent performance.

1. As of 9/30/19, RingCentral INC represented 0.28% of total net assets of Franklin DynaTech Fund, Steris PLC represented 0.08% and Zoetis 0.07%. Most recent data available. Portfolio holdings are subject to change. The companies and case studies herein are used solely for illustrative purposes; any investment may or may not be currently held by Franklin DynaTech Fund. The opinions are intended solely to provide insight into how securities are analyzed.

2. Source: Morningstar(R). 12/31/19. For each mutual fund and ETF with at least a 3-year history, Morningstar calculates a Morningstar Rating™ based on how a fund ranks on a Morningstar Risk-Adjusted Return measure against other funds in the same category. This measure takes into account variations in a fund’s monthly performance, and does not take into account the effects of sales charges and loads, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars; the next 22.5% receive 4 stars; the next 35% receive 3 stars; the next 22.5% receive 2 stars and the bottom 10% receive 1 star. The weights are: 100% 3-year rating for 36–59 months of total returns, 60% 5-year rating/40% 3-year rating for 60–119 months of total returns, and 50% 10-year rating/30% 5-year rating/20% 3-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent 3-year period actually has the greatest impact because it is included in all three rating periods. The Fund’s advisor class shares received a Morningstar Rating of 5, 5 and 5 star(s) for the 3-, 5- and 10-year periods, respectively. Morningstar Rating™ is for the named share class only; other classes may have different performance characteristics. Past performance is not an indicator or a guarantee of future performance. Source: © Morningstar. Important data provider notices and terms available at www.franklintempletondatasources.com. © 2019 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

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