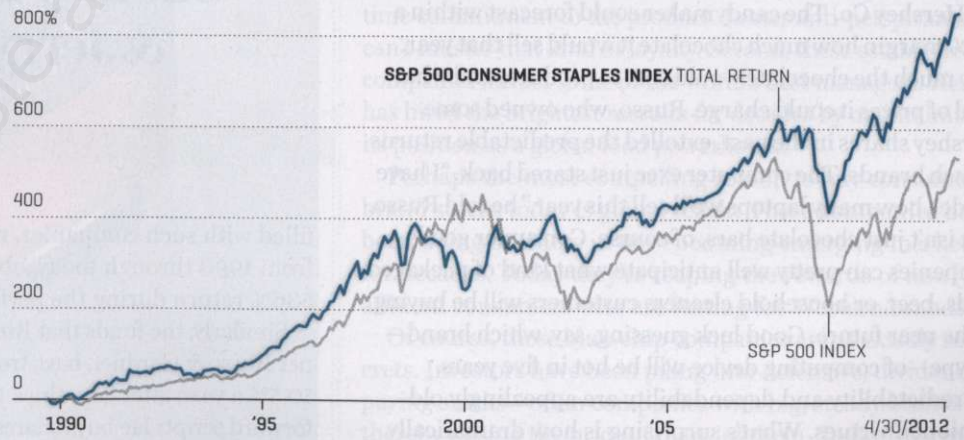

Bud
Budweiser
Budweiser
KING OF BEERS
pepsi
BAND-AID
FLEXIBLE FABRIC
BAND-AID
BRAND ADHESIVE BANDAGES
FLEXIBLE FABRIC
Flexible protection that moves with you
30
ALL-ONE SIZE
Johnson
HERSHEY'S
Milk Chocolate
NESCAFÉ

BET ON THE BRANDS

They may not be sexy, but food, drink, and household-product stocks can deliver stellar returns. Here's where some top fund managers see the best values today. *by Scott Cendrowski*

BRAND POWER Consumer staples stocks easily outperform the S&P.



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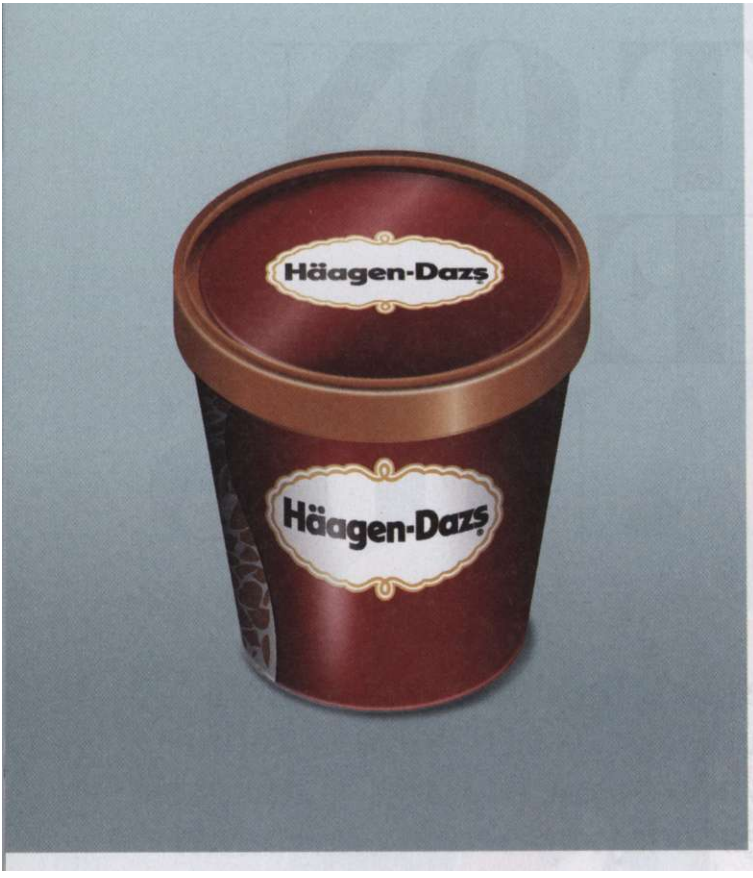

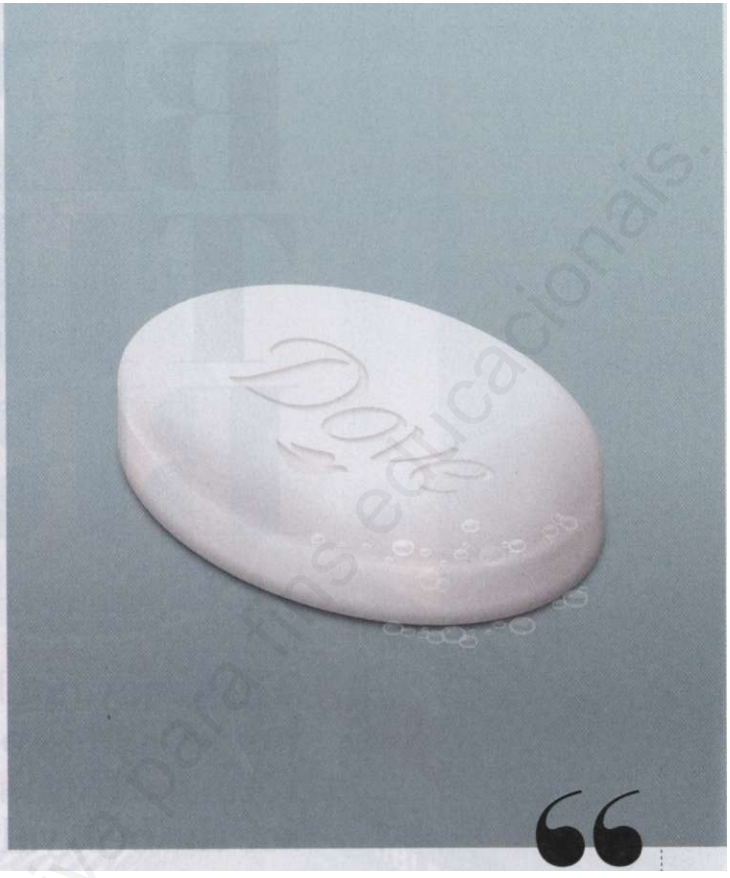

SOME YEARS AGO Tom Russo struck up a bit of in-flight chitchat with an executive at a computer company. Russo, who manages about $5 billion in private investment funds and individual accounts for wealthy clients, began raving about the Hershey Co. The candymaker could forecast within a 0.5% margin how much chocolate it would sell that year, how much the chocolate would cost to produce, and what kind of prices it could charge. Russo, who owned some Hershey shares in the past, extolled the predictable returns of such brands. The computer exec just stared back. "I have no idea how many laptops we'll sell this year," he told Russo.

It isn't just chocolate bars, of course. Consumer goods companies can pretty well anticipate what kind of packaged foods, beer, or household cleaners customers will be buying in the near future. Good luck guessing, say, which brand—or type—of computing device will be hot in five years.

Predictability and dependability are appealingly old-fashioned virtues. What's surprising is how dramatically they pay off for those who invest in the companies that sell those brands. The S&P Consumer Staples Index, filled with such companies, returned a total of 854% from 1990 through today, obliterating the S&P 500's 536% return during the period.

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Similarly, the funds that Russo manages at his firm, Gardner Russo & Gardner, have trounced the S&P 500,15.3% to 10.5% a year, after fees, since 1984 by following a straightforward script: He buys shares of the world's most popular brands in food, alcohol, and tobacco. His holdings read like a batch of businesses tasked with keeping the world fed and

happy (and sometimes clean). There's **Nestle** (whose brands include Cheerios cereal, Haagen-Dazs ice cream, Gerber baby foods, and Lean Cuisine), **Unilever** (everything from Lipton tea and Hellmann's mayo to Dove soap and Vaseline), **Philip Morris International** (which sells Marlboro cigarettes outside the U.S. and is Russo's top holding), and global beer brewers **Heineken Holding, SABMiller,** and **Anheuser-Busch InBev.** He owns shares of the distillers behind Jack Daniels and Captain Morgan too.

"You know DRAM computer chips?" asks Russo, a hyperenergetic 56-year-old, over breakfast in Midtown Manhattan. "I can't deal with those. What I do understand is a dram of Scotch whisky—that's something I get!"

Russo isn't alone. There's a coterie of mutual fund managers who could be called the "brand apostles": Don Yacktman of the Yacktman Funds; Will Browne, who co-manages Tweedy Browne Global Value; David Winters of the Wintergreen Fund; and Jeff Auxier, who runs his own eponymous fund. Each has built a stellar long-term record by buying the shares of consumer brand companies.

These veteran investors say brands just might be the best bets in today's schizophrenic market. Think of them as tortoise stocks: They won't produce overnight riches (and you probably won't captivate guests at your next cocktail party by holding forth on Unilever's new plant in South Africa). But little by little, these stocks inch their way forward, and the effects of steady compounding and reinvested dividends add up to winning returns.

The best brands benefit from potent long-term advantages. They enjoy pricing power to overcome inflation. Procter & Gamble, for example, can hike prices of Old Spice deodorant because many customers make what is in effect a lifetime commitment to the product. Lesser anti-perspirants can't muster that kind of loyalty. Second, these established companies attract some of the world's best managers. Nestle has hired the brightest recruits for decades by maintaining its position as a global food powerhouse.

Perhaps the most compelling reason to buy consumer brand stocks today is global reach: These companies have been doing business in now-booming emerging markets for decades. Today they're reaping the rewards of newly affluent consumers who are lusting for Western brands.

Of course, these blue-chip companies aren't exactly secrets. Investors have been piling into defensive, dividend-paying stocks—often companies with big, steady brands—thereby raising the price of many of them. Today they trade at a 20% premium to the S&P, according to Capital IQ. Even a sterling performer can be too expensive at a given

THE SELECTIONS Follow the experts, or play the entire index.

STOCK	DIVIDEND YIELD	WHY THE BRAND APOSTLES LIKE IT
Philip Morris International	3.8%	It sells seven of the world's top 15 cigarette brands, says Tom Russo. Result: steady earnings and dividends.
PepsiCo	3.2%	Shares are selling well below their historical P/E ratio, notes Don Yacktman, who thinks Pepsi will rebound over time.
Unilever	4.0%	Growth in emerging markets will keep this multinational chugging along, in Jeff Auxier's view.
Johnson & Johnson	3.9%	J&J's battered valuation will improve, argues Will Browne, as the company addresses its quality issues.
Nestlé	3.2%	Another global powerhouse whose share price has temporarily dipped, says David Winters.
Consumer Staples Select Sector SPDR	2.7%	This diversified ETF tracks consumer staples in the S&P 500 and charges a rock-bottom 0.18% in fees.

moment. So we asked the brand apostles where the best values in the category can be found today.

THE MOST ADVANTAGEOUS TIME to buy brand stocks is usually when the company trips up and the price is briefly pummeled, says Don Yacktman, whose company manages $17 billion. At 70, Yacktman remains frugal. In his sparsely decorated Austin offices on a recent day, he wears Dockers khakis and a weathered Timex watch. He insists that his portfolio managers bring their own coffee to work. But Yacktman´s eye for value and his willingness to wait until a stock is priced right has paid off: The flagship Yacktman fund has returned 11.8% per year since the turn of the millennium (vs. 1.5% for the S&P). "The better the businesses you own," he says, "the more patient you can be. Because eventually they're going to come out of it."

His case in point: **PepsiCo.** Shares have gone nowhere for five years, some investors are calling for the CEO's head (see "Indra Nooyi's Challenge" on fortune.com), and earnings disappointed again in the first quarter. But Yacktman believes in the company. He has bought 20 million shares, now worth $1.6 billion, over the past two years, making the soft drink and snacks giant his biggest holding. Even a steady business like Pepsi goes through cycles, he says. It probably overpaid for a Russian dairy company and has fallen behind Coca-Cola in America's soda wars. All of which makes Pepsi cheap today. It trades at a price/earnings ratio of 15, below its five-year average of 18. Yacktman assumes Pepsi's core soft drink business will bounce back in the U.S. over the long term. He thinks that between its currently depressed shares and its 4% dividend yield, Pepsi could return 150% over the next decade. "In the long term they're going to be fine," says Yacktman.

Today is one of the best times in history to put money into global brands, says Jeff Auxier, 53, who runs $550 million from his 108-acre working farm in Lake Oswego, Ore. (to avoid the groupthink of Wall Street, he notes). He's been investing since the 1980s and running his own mutual fund since 1999. (It has generated a total return of ***6.6%*** per year.) With developed economies entering an extended period of deleveraging, Auxier says, brand companies are best positioned to prosper. Consumers will be forced to pinch pennies as governments curtail spending. Europe offers a glimpse of how difficult debt reduction can be.

One effect of deleveraging, according to Auxier: People will eat more meals at home. During previous deleveraging periods—the Great Depression is the best known—consumer food stocks posted strong gains because people cut back on extravagances without completely eliminating them. "They may not eat dinner out," says Auxier, "but they'll still buy Ben & Jerry's for dessert." **Unilever,** which has owned the ice cream purveyor since 2000, has a stable of other food brands that Auxier believes will benefit from consumers' new spending habits. That, combined with expanding demand in emerging markets, should keep the company's earnings growth chugging along at its decade-long clip of 7% per year. Shares trade at 15 times next year's earnings, in line with their long-term average, and yield 4%.

Auxier sees emerging-markets growth as helping fuel a world population boom—an expected increase of 1 billion people by 2025—a trend that is also influencing the managers at Tweedy Browne's Global Value Fund in New York. By 2015, for the first time in 300 years, they say, the number of Asian middle-class consumers will equal the number in Europe and North America.

That's just a bonus for buying brands, says Will Browne, who co-manages the $5 billion fund. Global Value has returned 6.3% per year since 2000 (vs. -1.2% for Morgan Stanley's Europe Australasia Far East index), and last year Morningstar named it international stock fund of the year. Tweedy owns shares of Nestle, Coca-Cola Femsa (the company's bottler in Mexico and South America), and Heineken

not because Browne and his co-managers were running to get in front of a population boom, but because the companies always had a leg up on competition in countless markets across the globe. "We're looking for businesses that have sustainable, predictable demand characteristics,'" says Browne. "In many cases, that happens to be brands." Tweedy thinks **Johnson & Johnson,** with its roster of health care staples like Band-Aids and Tylenol, offers particular potential right now. J&J grew earnings per share by more than 10% annually over the past decade while its P/E collapsed from 32 in 1999 to 12.5 today. Tweedy believes that between its low valuation and 3.5% dividend yield, J&J is priced to deliver double-digit annual returns over the next decade. "They've had issues—some product recalls over the last several years," admits co-manager Bob Wyckoff. "But generally the company has been well managed over decades, and we're not convinced that's not going to continue."

In the early 2000s, David Winters, who learned at the knee of the legendary (and ferocious) value investor Michael Price, fought company managements to generate returns, earning a reputation as a shareholder activist and a master of distressed investments. But since the financial crisis Winters has mostly dropped the pressure tactics and just bought stocks—especially the well-regarded consumer brands that he calls some of the cheapest equities available today. Winters' $1.7 billion Wintergreen Fund has returned 6.8% a year since its founding in 2005, compared with 4.9% for the S&P. Winters has always hunted for companies with three traits: pricing power (to beat inflation), an improving business, and good management. For years that's meant a stake in **Nestle,** the Swiss food giant with hundreds of brands on sale across the globe. The company's already deep reach in developing markets, which represented 36% of sales in 2010, is expected to rise to 45% by 2020. Nestle recently got cheaper. After it acquired Pfizer's infant nutrition division earlier this year for $12 billion, shares dropped 5%. But don't worry, says Winters: "It positions them for forever." When it comes to brand stocks, Wall Street's short-term worries will only benefit long-term holders—and provide entry points for buyers.

Fonte: Fortune, Amsterdan, v. 166, n. 1, p. 60-65, 2 July 2012.