



Epoch Investment Partners:
(from left) Tim Taussig, Phil Clark,
Bill Priest, and David Pearl

Epoch Investment Partners

New York, New York
Managed assets: \$5.4 billion

“In the 1990s, if you wanted to be a professional investor,” says David Pearl, one of Epoch’s founding partners, “you wound up working for a bank or insurance company, because the investment industry was consolidating, but that pendulum has swung the other way.” Pearl and three experienced colleagues opened the firm in 2004: Three of the founders worked together in the 1980s at boutique manager BEA Associates, which was folded into Credit Suisse Asset Management. William Priest, the founder of BEA, was retired at age 60 by Credit Suisse’s corporate machine in 2001; today, he is CEO of Epoch. The fourth founder came to Epoch via the value investing giant, Sanford C. Bernstein & Co.

“Our investment style is a logical, powerful process that people relate to,” Pearl declares, “but style has been a problem for us, too, because we don’t fit easily into the way consultants like to organize managers.” Epoch is definitely on the value side of the scale, Pearl says, “but the more accurate way to view our philosophy is ‘free cash-flow generation.’ We look for businesses that are very profitable as measured by the cash they generate, and how astutely they put that cash to work.” He likens the firm’s cash-flow metrics to the way private equity firms size up their investments,

“as opposed to the public markets’ focus on accounting figures like earnings and book value. There is a big disconnect between generally accepted accounting principles and real, cash flow-based economic measures.”

“Our other investment judgment factor,” Pearl observes, “is how well management handles a company’s free cash flow. There are only five things you can do with excess cash flow,” Pearl says. One is to grow by reinvesting in the company, and two is to grow through acquisition. Three through five involve returning the extra cash flow to the owners—what Epoch terms “the shareholder yield”—via dividends, or repurchasing debt or shares.

“The public market likes growth better and tends to put higher valuations on companies that are reinvesting or acquiring, whether or not they should be,” explains partner David Pearl. “We find a lot of mispricings of companies that are really profitable in cash flow terms and have a high shareholder yield, but aren’t super growth companies that the public market likes. They’re mature businesses, but still can be terrific stocks, and they can be ideal for LBOs.”

Epoch runs nine equity strategies: four in the U.S. market, and five with an international or global slant. The two largest, with more than \$1 billion each under management, have benefited from the move of many investors

to release traditional constraints. “Forcing a manager to track an index or stick to style boxes, which can be arbitrarily constructed, may cause people to lose alpha,” says David Pearl. “We’ve seen a move in the last year from strategies restricted to large- or small-cap stocks to ‘all-cap,’ where the manager can show alpha by choosing between large or small. The next move is toward global all-cap strategies.”

Epoch has had an all-cap U.S. strategy since 1994 and beaten the Russell 3000 stock index by 3.6% over the full period. Its Global Choice portfolio, started up in late 2005, has beaten the MSCI World index by 10.5% annualized since inception, and the Global Choice strategy has beaten the same index by 5.6% since its introduction in January 2006. In 2002, Epoch created an Absolute Return fund, which does not sell short but makes large allocations to cash; its annualized return versus the MSCI World index has been 3.8% for the three years ended March 2007.

“You would think that anyone could do our cash-flow analysis with a computer,” says Pearl, “but, in fact, there are few usable reported numbers on cash flow. However, the best indicator, says Pearl, “is that, anytime a company says they are going to split themselves up, it’s a signal that the market doesn’t get it.” —John Keefe

Photo by Josh Lutz