# A Discussion With The TorrayResolute Fund Portfolio Manager

TORRAY LLC

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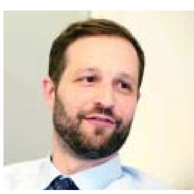

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## A TORRAYRESOLUTE SMALL/MID CAP FUND PERSPECTIVE

The TorrayResolute Small/Mid Cap Growth Fund is a mutual fund that is available in institutional and investor share classes, with an inception date of December 31, 2014. Portfolio Manager Nicholas Haffenreffer talks about the asset class, his approach and why he believes now is a good time to be in Small/Mid Cap Growth.

***Q: Do you think stock prices accurately reflect company fundamentals in today's market?***

**Nicholas:** No, not uniformly. The post-financial crisis period has been a unique time for the markets; we've had exceptionally low interest rates and low economic growth for a long time – a full decade now. What that's done is push fundamental factors like valuation and balance sheet strength to the background. High growth companies and non-earners seemingly have become substitute staples, viewed as the "safe bet", which is counterintuitive. This is particularly the case in the Tech sector. Given the duration of this cycle and the increasingly narrow nature of the market's leadership, we think it's important to exercise caution here… and continue to be disciplined, focusing on valuation and business fundamentals. This cycle may be unique, but we do not consider it immortal.

***Q: How should I interpret your performance and what attributes should I be aware of that may not be so obvious?***

**Nicholas:** Our record is very clear on this. Historically, we have typically done well when prices are dictated by fundamentals and there is regular market volatility. We tend to underperform when momentum or early cycle companies lead. The reason for this is that momentum is associated with higher valuations, and one of the ways we attempt to manage risk is to be disciplined about valuation. We also tend to underperform when early cycle companies lead because they are, by definition, characterized by more cyclical financial results. Our focus on sustainable growth generally leads us to avoid these types of companies. Based on these factors, we've faced some style headwinds recently, but we believe this will change with time as economic and market cycles evolve.

***Q. You mentioned risk, so how do you define risk?***

**Nicholas**: Institutions typically view risk as volatility, both on the upside and downside. Individuals tend to focus more on downside risk or losses. We definitely focus on the latter, the idea of risk as loss. From our belief in the Low Volatility Anomaly where low beta stocks outperform over time, and our Risk-Adjusted Growth model which identifies stable growth characteristics, to our Correlation Analysis which targets effective diversification, mitigating the risk of loss is at the core of what we focus on. An ideal scenario for us would be over the long term, participate in most of the upside but limit loss on the downside. What we don't want to do is underperform in down markets. This is a characteristic that differentiates our strategy and is very important to our clients, both institutions and individuals.

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***Q: You run a concentrated portfolio. Why do you use a limited number of stocks and how does that integrate with your focus on risk management?***

**Nicholas:** We believe effective investing requires leveraging our research, our best ideas, and taking a long-term view. One of the concerns about growth investing as an asset class, is that investors must assume excess risk. We fundamentally disagree. There are only so many exceptional businesses. Once you find them, they tend to do the work for you. If you study successful investors, you'll note that many tend to hold their positions for decades. What they do right is they get the company right and have the discipline to stick with it. We limit our portfolios to 30 of our highest conviction names, the ones we believe will maintain risk characteristics below our benchmark but allow us to participate in the upside. In addition to our fundamental research, we conduct extensive correlation analysis[4] – we've found this to be an effective tool in maintaining diversification across portfolios with fewer stocks.

***Q. In the past, you've talked about consistency of returns, growth in margin and cash flow, while also commenting on pricing power and barriers to entry. Those last two are more qualitative, with the former being more quantitative. Does one type carry more weight in your process?***

**Nicholas:** It's fair to say we give more weight to our qualitative work, but it must be supported by our quantitative analysis. The two approaches should complement each other. It's hard to imagine a great qualitative business that doesn't generate attractive quantitative factors, and vice versa. For example, we use our risk-adjusted growth process, which is quantitative, to identify stable growth companies. Qualitatively, we look to add value by understanding how these companies produced their results in a sustainable manner.

***Q: Is there something I haven't asked about or something you think investors need to know about the process or the strategy?***

**Nicholas:** One of our core tenets is that "process is a better approach than information advantage or intuition." Asset managers frequently offer a strategy emphasizing one of these three ideas – process or rules, information advantage or unique insights, and intuition or experience. While all of these characteristics play an important role, process is the most repeatable factor. We think process should help explain a manager's returns. Without it, the client is left guessing or simply chasing past performance, which we think is not a very compelling investment proposition. We believe all clients should know what you do, how you do it, and in doing so, what to expect.



**Beta**: a measure of the volatility of an individual stock in comparison to the unsystematic risk of the entire market.
**Low Volatility Anomaly**: The belief that over the long run, stock portfolios with lesser variance in monthly returns have experienced greater average returns than their 'riskier' counterparts.
**Risk-Adjusted Growth Model**: is a method of analyzing companies on the basis of growth consistency.
**Correlation Analysis**: is a matrix used to see how each stock's price correlates with every other stock in the portfolio overtime with a goal of minimizing correlation in the portfolio.
**Correlation**: Indicates the strength and direction of a linear relationship between two random variables. A value of 1 indicates a perfect positive dependency and -1 indicates a perfect negative dependency between two investments.
**Margin**: is the difference between a product or service's selling price and the cost of production, or the ratio of profit to revenue.
**Cash Flow**: is the net amount of cash and cash-equivalents being transferred into and out of a business.