



TORRAY LLC

Investment management since 1972

## TorrRayResolute Concentrated Large Growth

### Market Overview

Eight years into this bull market, it's hard not to be impressed by and somewhat leery of the market's persistent advance. In fact, this is the second longest bull market on record. The combination of deep skepticism following the financial crisis, moderate economic growth, an absence of inflation, and accommodative interest rates goes a long way toward explaining the market's resilience. Stocks continued to march ahead in the second quarter, generating solid returns on the back of an outstanding first quarter. Leadership in the first half of the year stands in stark contrast to the best performing stocks in late 2016, which concluded with a powerful cyclical rally in Industrials, Financials and Materials following the surprise election of Donald Trump. As the new administration's honeymoon drew to a close with the inevitable reality of political battles, economic fundamentals retook center stage, as did the leadership of a short list of seemingly expensive large cap growth stocks. Given this group's lack of breadth and valuation support, it is curious, if not counterintuitive, that investors have increasingly come to view the group as "defensive." While there may be something to be said for the phrase "the best defense is a good offense," we maintain that a disciplined approach with respect to valuation and diversification should not be ignored.

Eight years into this bull market, it's hard not to be impressed by and somewhat leery of the market's persistent advance.

### Portfolio Commentary

For the second quarter, the Large Growth Composite gained 4.45% (4.36% net of fees), performing in line with the benchmark Russell 1000 Growth Index's return of 4.67%. On a year-to-date basis, the composite returned 13.64% (13.44% net of fees), just shy of the benchmark's advance of 13.99%. It has clearly been a rewarding first half of the year for equity investors, particularly those invested in growth stocks, with the Russell 1000 Growth Index outperforming the Russell 1000 Value Index by 933 basis points and the S&P 500 Index by 465 basis points. During the quarter, a benign regulatory environment provided the basis for leadership from the Health Care and Financial sectors, while the Energy sector remained weak as concerns regarding oversupply kept commodity prices under pressure. Portfolio sector allocation was neutral to relative returns and stock selection was modestly negative. The quarter's top contributors included a diverse group of holdings - Cooper Companies (COO), Alphabet (GOOGL) and LKQ Corp. (LKQ) and top detractors were Akamai Technologies (AKAM), O'Reilly Automotive (ORLY) and EOG Resources (EOG). Portfolio activity for the quarter included the purchase of Check Point Software (CHKP) and O'Reilly Automotive (ORLY) and the sale of Gilead Sciences (GILD) and Akamai Technologies (AKAM).

**Check Point Software (CHKP)** The increasing incidence and severity of cyberattacks are a troubling fact of commerce and private life. Founded in 1993 and headquartered in Tel Aviv, Israel, Check Point Software is a well-established cybersecurity company with a broadly-diversified global customer base. The company's enterprise software and

hardware products provide a broad array of solutions designed to detect, stop and remedy cybersecurity threats. We invested in Check Point because we believe demand for cybersecurity solutions will continue to increase for the foreseeable future. For example, research firm Cybersecurity Ventures predicts ransomware damages will exceed \$5 billion in 2017, more than 15 times the \$325 million reported in 2015. International Data Corporation (IDC) forecasts worldwide cybersecurity spending will increase from \$74 billion in 2016 to \$102 billion in 2020, a compound annual growth rate of 8%, which is more than twice the rate of projected general IT spending. Within this fragmented and highly competitive industry, Check Point is differentiated by its stable financial history, best-in-class profit margins and low capital requirements.

**O'Reilly Automotive (ORLY)** O'Reilly Automotive is one of the largest and best-managed aftermarket auto parts retailers in North America with a financial track record that speaks for itself. Over the past five years, revenues have increased at a compound rate of 8%, net income at 15% and earnings per share at 23%. With 27 distribution centers and 305 "hub" stores, O'Reilly is able to replenish all 4,829 stores across 47 states on a daily basis, a distinct competitive advantage, particularly in the commercial Do-It-For-Me (DIFM) sales channel. The timely availability and delivery of parts is the principal factor in a mechanic's decision on where to purchase parts. Additionally, O'Reilly operates in an industry benefitting from two secular tailwinds: increasing average vehicle age and increasing miles driven. Both trends drive demand for replacement parts. Recent concerns regarding mild weather and competition, particularly Amazon's (AMZN) entrance into the \$50 billion retail Do-it-Yourself (DIY) market, have pressured O'Reilly's stock and created what we believe to be an attractive opportunity to invest in the company. While it would be a mistake to ignore a competitor like Amazon, O'Reilly's service-based competitive advantages and exemplary operating record lead us to believe that it will compete effectively and continue to benefit from the industry's long-term secular growth trends.

**Gilead Sciences (GILD)** During the course of our seven-year holding period, Gilead managed the most successful drug launch in history, with Sovaldi (a cure for Hepatitis C) reaching peak annual sales of \$19 billion. While sales of Sovaldi have slowed, the drug's success allowed the company to build large cash reserves, repurchase approximately 15% of its shares outstanding, institute an attractive dividend and increase research and development spending. We applaud the steps management has taken, but believe it is prudent to move to the sidelines until a clear path for growth is reestablished.

**Akamai Technologies (AKAM)** We purchased shares of Akamai Technologies in November 2013 based on the thesis it represented a classic indirect or "pick-and-shovel" approach to participating in the persistent global demand for digital content and cloud computing. Akamai is the largest stand-alone provider of content delivery network (CDN) services which help make the internet fast, reliable and secure. The company has more than 230,000 servers placed inside 1,600 networks across 130 countries. It is a unique and somewhat capital-intensive asset that is hard to replicate. Founded in 1998 and headquartered in Cambridge, Massachusetts, Akamai has delivered impressive financial results, increasing revenues, earnings and cash flows at compound average growth rates of 12%-15% over the last five years. What we did not anticipate in our initial analysis was the competitive risk posed by the financial success of Akamai's largest customers. Starting in 2015, key customers such as Apple (AAPL), Microsoft (MSFT) and Facebook (FB) began to build out and utilize their own networks, insourcing some of the services Akamai provides. While Akamai has done an admirable job of diversifying its business and aggressively expanding its internet security division, the change in product mix has negatively impacted the company's stable, high-margin structure, tempered growth, and introduced an unappealing degree of uncertainty. Given these developments, we sold shares of Akamai.

## Outlook

In spite of elevated geopolitical risks and moderating expectations regarding the Trump Administration's ability to achieve its ambitious economic agenda, equity markets continued to demonstrate remarkable resilience during the first six months of 2017. Beneath the headlines, a synchronized global expansion continues to build momentum and reaccelerate earnings growth after a three-year drought. Valuations are high by historical standards, but the market's advance is supported, at least in part, by an absence of inflation and the probability that interest rates will remain relatively low for a long time. We continue to evaluate the potential impact of the primary policy changes proposed by the new administration and believe the portfolio's exposure to both risks and opportunities is balanced. We remain focused on valuations and on identifying attractive investment opportunities as they emerge from the intersection of economic fundamentals, politics and geopolitical events.

As ever, we appreciate your interest and trust.



Nicholas C. Haffenreffer

July 11, 2017

### Top Contributors & Detractors

Security	Sector	% Contribution
Cooper Companies	Health Care	+0.7
Alphabet Inc.	Info Tech	+0.5
LKQ Corporation	Cons Disc	+0.5
Cerner Corporation	Health Care	+0.5
American Tower	Real Estate	+0.4
Akamai Technologies	Info Tech	-0.4
O'Reilly Automotive	Cons Disc	-0.3
EOG Resources	Energy	-0.2
Incyte Corporation	Health Care	-0.1
Enbridge Inc.	Energy	-0.1

### Top 10 Holdings

Security	% of Holdings
Alphabet Inc.	4.9
Charles Schwab	4.2
Apple Inc.	4.1
Facebook, Inc.	4.1
Visa Inc.	4.0
American Tower	4.0
Fiserv, Inc.	3.9
Accenture Plc	3.9
Cerner Corporation	3.9
Roche Holding Ltd	3.6
<b>Percentage of total portfolio</b>	<b>40.6</b>

Holdings are subject to change and are not recommendations to buy or sell a security. To obtain information about the calculation methodology used to select the largest contributors to and detractors from performance or to obtain a list showing every holding's contribution to performance during the measurement period, contact [tawney@torray.com](mailto:tawney@torray.com).

**Disclosures:** This commentary is for informational purposes only and should not be viewed as a recommendation to buy or sell any security. There is no guarantee that the views expressed will come to pass. Torray LLC is an independent registered investment adviser. Registration of an investment adviser does not imply any level of skill or training. Torray LLC claims compliance with the Global Investment Performance Standards (GIPS®). To receive a list of composite descriptions of Torray LLC and/or a GIPS® compliant presentation, please contact Hugh Tawney or Breck Scalise at 855.753.8174 or email [tawney@torray.com](mailto:tawney@torray.com). For additional information about Torray LLC, including fees and services, please contact us or refer to the Investment Adviser Public Disclosure website ([www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)).

The Russell 1000® Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

**Investing involves risk; principal loss is possible. Past performance is not indicative of future results.**