



TORRAY LLC

Investment management since 1972

Torrays Resolute Small/Mid Cap Growth

Market Overview

The phrase, “Never judge a book by its cover” is an appropriate metaphor to use when describing the deceptively benign equity returns for the first quarter of 2018; the Russell 2500 Growth Index’s modest gain of 2.38% masks the severe volatility experienced by investors over the course of the period. Following the late December passage of the U.S. Tax Reform Act, enthusiastic investors drove the index up 4.99% in January, but subsequent concerns regarding inflation, rising interest rates, trade policy and the prospect of increasing regulation of the market-leading Information Technology sector knocked the index down 2.74% over the course of the following two months. From the January 26th high to the February 8th low, just ten trading days, the Russell 2500 Growth Index declined 9.54%, the first correction in two years. The surprising return of volatility raises the question, are we in a new phase of the market’s cycle or simply pausing in advance of higher levels?

Portfolio Commentary

The Small/Mid Cap Growth Composite gained 2.81% (2.62% net of fees) for the quarter, modestly outperforming the benchmark’s advance of 2.38%. Information Technology continued to be a source strength for the portfolio and benchmark, while the Energy sector weighed on returns in spite of recovering oil prices. At the security level, top contributors included Qualys (QLYS), Copart (CPRT), and Genmab (GMXY). Primary detractors included Omnicell (OMCL), Biomarin Pharmaceuticals (BMRN), and Affiliated Managers Group (AMG). Overall, security selection and sector allocation were positive for the quarter.

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It was an active period in the portfolio with the initial purchases of Webster Financial Corporation (WBS) and Healthcare Services Group (HCSG), and the sale of HD Supply Holdings (HDS) and Criteo (CRTO). Webster Financial is a New England-based regional bank that is also the Nation’s second largest provider of Health Savings Accounts (HSAs) with approximately 14% market share. HSAs are tax-advantaged accounts provided to employees with high-deductible medical plans to save and pay for medical expenses. Industry deposits currently total approximately \$45 billion and are expected to grow at a compound average rate of more than 20% for the next five years. Demand is based on the increasing responsibility of patients to pay for and control their medical spending. With a stable bank behind the HSA business and the stock at an attractive valuation, we believe Webster is a compelling way to participate in this strong secular trend.

Healthcare Services Group is the largest third-party provider of housekeeping, laundry and dining services to the healthcare industry in the United States. Founded in 1976 and serving 3,800 nursing homes and rehabilitation centers in 48 states, HCSG is the only industry player operating on a national scale and has grown with the industry’s

need to contain costs through the outsourcing of these basic services. While the integration of large contracts has recently pressured margins and weighed on the stock price, we believe positive demographics, high recurring revenues, generous cash flows and client retention rates in excess of 90% support a continuation of the company's strong financial results and debt-free balance sheet.

We recently sold our position in Criteo, a global leader in targeted digital advertising. While Criteo continues to expand its impressive client base, a lack of control over direct access to consumer information via website browsers poses a significant threat to its business, as evidenced by recent changes to Apple's Safari browser. Specifically, Apple's (AAPL) latest version of Safari incorporated a change in the default settings that limits the ability of websites to identify users. Without this knowledge, Criteo cannot accurately target the end-user with a personalized ad. Apple's Intelligent Tracking Prevention (ITP) effectively has the potential to disconnect Criteo from a significant portion of iPhone users causing Criteo to lose a large part of its advertising market. If other browsers follow Apple's lead, Criteo's fundamental business model would be in jeopardy. In order to avoid this specific risk and generally acknowledge the increasing uncertainty in the advertising technology space, we exited the position. We also sold our position in industrial distributor HD Supply. The pervasive shift to online selling and associated pricing transparency has been a steady headwind for industrial distributors, particularly those that lack a differentiated service niche. As HDS has sold several operating divisions in an effort to deleverage its balance sheet, the company has become more of a commodity player within the industry. This development and the experience of several management execution missteps led us to sell the stock.

Outlook

Over time, we believe earnings growth and interest rates are two of the most important factors driving equity markets. On this front, the backdrop remains positive; earnings growth is accelerating and interest rates have remained accommodative. Recent developments around trade, regulation and Federal Reserve policy largely explain the return of volatility. Only time will tell whether this marks a new phase of the market cycle. Given the strategy's focus on earnings quality, risk management and effective diversification, we believe the portfolio is well-positioned for both the short and long run.

As ever, we appreciate your interest and trust.



Nicholas C. Haffenreffer

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Top Contributors & Detractors

Security	Sector	% Contribution
Qualys, Inc.	Info Tech	+0.9
Copart, Inc.	Industrials	+0.9
Genmab A/S	Health Care	+0.7
Aspen Technology, Inc.	Info Tech	+0.6
PRA Group Inc.	Financials	+0.4
Omniceil, Inc.	Health Care	-0.4
BioMarin Pharmaceutical Inc.	Health Care	-0.4
Affiliated Managers Grp.	Financials	-0.3
Middleby Corporation	Industrials	-0.3
Healthcare Services Grp.	Industrials	-0.3

Top 10 Holdings

Security	% of Holdings
Copart	5.4
Hexcel Corporation	4.3
Jack Henry & Associates	4.2
Dycom Industries, Inc.	4.1
Cooper Companies, Inc.	4.1
Affiliated Managers Grp.	4.0
Qualys, Inc.	4.0
LKQ Corporation	3.9
Aspen Technology, Inc.	3.9
Omniceil, Inc.	3.8
Percentage of total portfolio	41.7

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.

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The Russell 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe. The Russell 2500 Index is a subset of the Russell 3000® Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2500™ Growth Index measures the performance of the small to mid-cap growth segment of the U.S. equity universe. It includes those Russell 2500 companies with higher growth earning potential. You cannot invest directly in an index.

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