



Investment management since 1972

## TorrRayResolute Small/Mid Cap 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 Small/Mid Cap Growth Composite gained 3.44% (3.26% net of fees), modestly trailing the benchmark Russell 2500 Growth Index's return of 4.13%. On a year-to-date basis, the composite returned 10.63% (10.25% net of fees), matching the benchmark's advance of 10.63%. It has clearly been a rewarding first half of the year for equity investors, particularly those invested in growth stocks, with the Russell 2500 Growth Index outperforming the Russell 2500 Value Index by 868 basis points and the Russell 2500 Index by 466 basis points. The quarter's best performing sectors were Telecommunication Services and Health Care, while the Energy sector remained weak as concerns regarding oversupply kept commodity prices under pressure. Portfolio sector allocation was slightly negative to relative returns, primarily as a result of the portfolio's overweight allocation to the Energy sector, and stock selection was modestly positive. The quarter's top contributors included Mettler-Toledo (MTD), Cooper Companies (COO) and IPG Photonics (IPGP). Top detractors were Home Depot Supply (HDS), Tractor Supply (TSCO) and Middleby (MIDD). Portfolio activity for the quarter included the purchase of Dycom Industries (DY) and the sale of O'Reilly Automotive (ORLY), Tractor Supply (TSCO) and the acquisition of Rice Energy (RICE).

**Dycom Industries (DY)** Engineering and construction companies, by their very nature, are cyclical businesses and tend to lack the kind of stable growth characteristics we prefer. However, the emergence of broad, long-term capital spending cycles can offset this risk. In response to what is expected to be a four-fold increase in mobile data traffic over the next five years, telecom and cable companies are initiating large capital spending plans which may exceed \$130-\$150 billion over the next five-to-seven years on a collective basis. As the largest and only significant pure-play provider of telecom and wireline engineering and construction services in the U.S., Dycom Industries will be a direct beneficiary of this long-cycle growth opportunity. Founded in 1969 and almost exclusively focused on the wireline business, Dycom benefits from the cost advantages associated with scale and deep industry relationships based on a strong reputation for execution. Over the past five years, the company has increased revenues and earnings at compound average growth rates of 21% and 42%, respectively. We believe the healthy industry backdrop and strong competitive positioning bode well for Dycom's future.

**O'Reilly Automotive (ORLY)** Originally purchased in December 2007, O'Reilly Automotive, a leading North American aftermarket auto parts retailer, crossed a market capitalization of \$25 billion, exceeding the strategy's guidelines of "small-to-mid cap" by a wide margin. This, and the fact that the portfolio holds two other companies with exposure to the auto parts industry, led us to sell the holding.

**Tractor Supply Company (TSCO)** Operating 1,769 stores in 49 states, Tractor Supply is a differentiated retailer of products for the rural lifestyle which include feed, pet products, hardware and clothing. Its niche offerings, loyal customer base and geographic expansion opportunities produced an admirable record of consistent growth through the end of 2015, at which time a confluence of challenges began to emerge. These included adverse weather, economic weakness in energy and agricultural-dependent geographies, and increased competition in key product lines such as pet food. While we were patient with this investment, the persistence of these headwinds led us to sell the stock. We will reassess the situation if and when the company's fundamentals stabilize.

**Rice Energy (RICE)** Shares of Rice Energy were sold following the June 19<sup>th</sup> announcement that the company would be acquired for \$6.7 billion in cash and stock by EQT Corp. (EQT), a Pittsburgh-based natural gas production and transmission company. We initially purchased Rice based on its exceptional record of growth and profitability in spite of low commodity prices. As an early entrant in the productive Marcellus and Utica shale plays, Rice had the opportunity to acquire best-in-class assets at attractive prices and grew into one of the industry's lowest cost producers with excellent long-term growth prospects. Because we believe EQT's assets and operations are inferior to Rice's, and the majority of EQT's offer is in the form of stock, we viewed the combination unfavorably and exited the investment.

## 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 17, 2017

#### Top Contributors & Detractors

Security	Sector	% Contribution
Mettler-Toledo	Health Care	+0.9
Cooper	Health Care	+0.8
IPG Photonics	Info Tech	+0.7
Ansys	Info Tech	+0.5
SBA Communications	Real Estate	+0.5
HD Supply	Industrials	-0.8
Tractor Supply	Cons Disc	-0.5
Middleby	Industrials	-0.4
Core Laboratories	Energy	-0.4
Manhattan Associates	Info Tech	-0.3

#### Top 10 Holdings

Security	% of Holdings
Omniceil, Inc.	4.6
Hexcel Corporation	4.6
Copart, Inc.	4.5
SBA Communications Corp.	4.4
Jack Henry & Assoc., Inc.	4.3
LKQ Corporation	4.1
IPG Photonics	4.1
Cooper Companies, Inc.	4.1
Affiliated Managers Group, Inc.	4.0
Mettler-Toledo	3.6
<b>Percentage of total portfolio</b>	<b>42.2</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 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.**