TORRAY LLC

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TorrayResolute Small/Mid Cap Growth

Market Overview

The familiar phrase "expect the unexpected" is memorable in part because it makes no sense. Yet, this is exactly what we experienced and what we became accustomed to in 2016. The United Kingdom's decision to leave the European Union and the U.S. election of Donald Trump were considered long shots at best; outcomes uniformly expected to roil financial markets. Contrary to expectations, investors embraced change, or at least the promise of change, and pushed equity markets higher. The backdrop for this constructive, if unexpected response, was stable and improving economic fundamentals. As we move into the New Year, our focus is on how these changes might occur and their impact on the economy and markets.

Portfolio Commentary

The Small/Mid Cap Growth Composite declined 1.53% (-1.72% net of fees) for the fourth quarter, underperforming the benchmark's gain of 2.60%. While this was a disappointing conclusion to the year, performance for the full year was good on an absolute basis; the composite gained 9.15% (8.38% net of fees), falling just shy of the benchmark's gain of 9.73%, and finished in the top third of the Mid-Cap Growth peer group.

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Security selection was the principal source of underperformance for the quarter, led lower by weakness in shares of healthcare and higher education consultant Advisory Board Company (ABCO). The evolving regulatory environment and uncertainty associated with the presidential election tempered demand for the company's products and services. Over time, we expect the challenge of increasing healthcare productivity and the adoption of value-based reimbursement plans will stabilize and improve demand. Top detractors for the period also included LKQ Corporation (LKQ) and Qualys (QLYS). In contrast to the weakness in these shares, strong performance was exhibited by portfolio holdings that share an industrial base and economic sensitivity; top contributors were HD Supply (HDS), Hexcel (HXL) and IPG Photonics (IPGP).

It was an active period for the portfolio with four purchases and one sale. We made initial investments in industrial software provider Aspen Technology (AZPN), management consultant ICF International (ICFI), Danish biotech company Genmab (GMXAY), and returned to Pennsylvania-based exploration and production company Rice Energy (RICE). Aspen provides mission-critical software to engineers, primarily in the chemical and energy industries, which aids the operation of facilities in a safe and efficient manner. The combination of secular growth in the company's end markets and subscription-based licensing agreements generate attractive financial characteristics. ICF provides both consulting and implementation services to public and private entities. The long-term nature of the company's contracts and diversified end markets support a stable, cash-generative business. Genmab's development of Darzalex, a drug targeting multiple myeloma, has the potential to revolutionize the treatment of the 250,000 patients in the US and EU who suffer from this form of cancer and generate approximately $5 in annual earnings per share in the next 4-5 years. Rice Energy is a low-cost natural gas producer with upstream and midstream assets in the prolific Marcellus and Utica basins. Despite historically weak commodity prices, Rice has maintained attractive production growth and profitability through a turbulent cycle. We expect long-term secular demand resulting from the exportation of liquefied natural gas and coal-to-gas switching will sustain and augment Rice's growth profile over time. Finally, shares of font design and marketing company Monotype Imaging Holdings (TYPE) were sold following the acquisition of a company we viewed as uneconomic and outside of its core competency.

Outlook

There were two or three phases of the market in 2016, depending on how you count them; in the first half of the year, defensive stocks led cyclicals. In the second half, the trend reversed and cyclicals exploded higher post-election, with investors projecting that the Trump administration's business-friendly campaign platform of tax cuts, infrastructure spending and deregulation would bolster future economic activity. A frequent question we received prior to, and immediately following the election, was regarding the changes we had made to the portfolio in consideration of this event. As unsatisfactory as it may seem, our response was "none." While extraordinary events such as Brexit and the election of Donald Trump introduce risks and opportunities, it is, as we have been reminded this year, difficult to consistently predict the outcome of such events. We have evaluated the potential economic impact of the primary policy changes proposed by the new administration and believe the portfolio's risk exposure is balanced. As such, our approach to investing remains unchanged. As we look out to the New Year, we ask a question we expect many investors do: "Was 2016 a triumph of hope over reason or an inflection point for positive economic change?" We expect a bit of both.

As ever, we appreciate your interest and trust.

Nicholas C. Haffenreffer
January 20, 2017

Top Contributors & Detractors

Security	Sector	Contribution
HD Supply	Industrials	+1.0
Hexcel Corporation	Industrials	+0.8
IPG Photonics	Info Tech	+0.5
Tractor Supply	Cons Disc	+0.4
ICF International	Industrials	+0.3
Advisory Board	Industrials	-0.9
LKQ Corporation	Cons Disc	-0.7
Qualys	Info Tech	-0.6
Rice Energy	Energy	-0.6
Omnicell	Health Care	-0.5

Top 10 Holdings

Security	% of Holdings
Hexcel Corporation	4.6
Jack Henry & Associates	4.6
Copart	4.3
LKQ Corporation	4.2
Mettler-Toledo	4.1
HD Supply	4.1
Omnicell	4.0
Affiliated Managers Group	3.9
Manhattan Associates	3.7
SBA Communications	3.7
Percentage of total portfolio	**41.3**

Holdings are subject to change and are not recommendations to buy or sell a security.