



TORRAY LLC

Investment management since 1972

TorraysResolute Concentrated Large Growth

Market Overview

The third quarter served as a rude awakening after years of relatively steady market appreciation. Volatility jumped to levels not seen since the financial crisis and equities delivered their worst returns in four years. While it is overly simplistic to point to a single cause, events in China played a major part in roiling the markets. The deteriorating economic data from the world's second largest economy, a heavy-handed devaluation of the yuan and the prospect of global currency wars contributed to higher volatility. Coupled with ongoing uncertainty around the Federal Reserve's course of action, investors grew increasingly concerned about global growth and broadly withdrew support.

Portfolio Commentary

During the third quarter, the TorraysResolute Concentrated Large Growth Composite declined 7.9% (8.0% net of fees), underperforming the benchmark Russell 1000 Growth Index, which fell 5.3%. For the trailing twelve months, the Composite gained 1.9% (1.6% net of fees) versus the benchmark's advance of 3.2%. The

primary cause of the strategy's underperformance for both periods was its allocation to energy, which averaged 8% for the quarter and 9% for the year compared to the benchmark's weight of 1% for the quarter and 4% for the year. While the portfolio's allocations were modest, declines in the sector were severe enough to adversely impact performance. For the quarter, defensive sectors such as consumer staples and utilities held up best, while weakness throughout the commodity complex pushed energy and materials sectors lower. Health care was also weak at the end of the quarter, as the debate on drug pricing made its way back into the headlines. Additionally, market leadership has narrowed, with just a few companies generating the majority of the benchmark's returns. We are fortunate to own several of these securities, including Apple (AAPL), Gilead (GILD) and Google/Alphabet (GOOGL), but expect outperformance will be difficult until breadth improves.

Activity in the quarter was driven by the desire to reduce cyclical exposure while upgrading the portfolio, emphasizing secular growth and discipline on valuation. Purchases for the period included Stericycle (SRCL) and Whole Foods Market (WFM). Stericycle is a \$2.9 billion logistics company that provides essential services to highly regulated industries such as medical waste management, document destruction and product recalls. The business benefits from durable secular trends such as rising medical spending and increasing regulatory requirements across diverse industries. With 95% of its revenues tied to long-term contracts, SRCL generates consistent growth, stable margins and generous free cash flow with little economic sensitivity.

Whole Foods Market (WFM) is the largest natural and organic grocer with 400 locations generating approximately \$14 billion in annual revenues. As the pioneer in the industry, WFM has successfully leveraged its first-mover advantage

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to build a brand and scale that generates industry-leading margins and returns. Operating in the fastest growing segment of the grocery industry, WFM has ample room to expand through the use of its unlevered balance sheet and strong cash flows, targeting 1,200 locations over the next two decades.

Sales for the period included Cummins (CMI) and FMC Corporation (FMC). Despite a history of innovation and operating efficiencies, engine manufacturer Cummins faces several challenges beyond their control. With 48% international sales, unfavorable exchange rates, declining emerging market growth, particularly in China and Brazil, acute weakness in key commodity-based markets, and the loss of a key client, we expect the operating environment for Cummins to remain unfavorable for the next few years. Given this uncertain outlook, CMI was sold.

Chemical manufacturer FMC was purchased in 2013 as a stable business within a cyclical sector, materials. We viewed demographic trends and the growing need for productivity in agriculture as key growth drivers. The agriculture business has faced multiple challenges which include a drought in Brazil and bumper crops in the U.S. These issues have been further complicated by exchange rate headwinds, as 67% of the company's revenues come from overseas. These events have reduced visibility on future profits, and we decided to swap the capital into less cyclical businesses.

Outlook

In the current environment of low growth, there is little tolerance for uncertainty or room for error. Given the challenges of the 25% appreciation of the U.S. dollar over the past twelve months, the 50% decline in the price of oil, and the rebalancing of developing economies, markets remain susceptible to higher volatility. Corrections typically cause a certain amount of indiscriminate selling, but in doing so, provide an opportunity to upgrade portfolio holdings. During these periods, we look to reduce exposure to investments that have more fundamental risks and reallocate capital to higher quality investments at more reasonable prices. We are encouraged by the level of innovation, compelling products and services, operating efficiencies and effective capital management demonstrated by current portfolio holdings. We expect these attributes to produce attractive returns over time, regardless of macroeconomic conditions.

As ever, we appreciate your interest and trust.



Nicholas C. Haffenreffer

October 15th, 2015

A fully compliant GIPS® disclosure presentation is available upon request.

Torray LLC is an independent registered investment adviser. To receive a list of composite descriptions of Torray LLC and/or a compliant presentation, please contact Hugh Tawney at 800.443.3034 or email Tawney@Torray.com.

Torray LLC claims compliance with the Global Investment Performance Standards (GIPS®).