TORRAY LLC

Investment management since 1972

TorrayResolute Equity Income

The Market

2021 proved to be another good year for financial assets, with the broad S&P 500 Index returning 11% in the fourth quarter and 29% for the year. This Index has delivered strong positive returns in four out of the past five calendar years, and in 17 of the past 20 quarters (85% of the observations). The obvious question is "why have returns been so strong for so long?" and a related, more subtle question comes to mind, "does risk still matter?"

Over much of this period, the market has struggled with risk from a variety of sources, including COVID19, geopolitics, interest rates and inflation. Seemingly, the correct decision in response to each disruption was to buy and hold, especially the stocks of the largest companies. Profits and associated growth have driven these generally positive returns. The supportive economy has enjoyed robust demand and, more importantly, innovative, highly productive supply to meet this demand. Many of these new supply solutions are products and services that are leverageable, meaning new units can be quickly and cheaply brought to market. Think software, social media platforms and medical therapies that address unmet needs. In this context, inflation has remained low (until recently) which in turn supports expansionary interest rates. The market believes these favorable conditions will remain in place into the future. So, if this narrative holds, risk likely remains a secondary concern for many investors.

Composite Portfolio

The Equity Income Composite fourth quarter return was 11.73% (11.59% net of fees) compared to 7.77% for the Russell 1000 Value Index and 11.03% for the S&P500. For full year 2021, the Composite return was 30.59% (29.91% net of fees) versus 25.16 % for the Russell 1000 Value Index and 28.71% for the S&P500. The global hunt for income, fixed or otherwise continues.

Positions in 3M Company (MMM) and CoreSite Realty Corp. (COR) were sold during the quarter. CoreSite agreed to be acquired by American Tower (AMT) in an all-cash deal. Anticipating a potential bidding war, the shares briefly traded above the offer price. We used this euphoria to exit the position. The transaction with American Tower closed on December 27. 3M was removed as we sought more stability and growth of free cash flow. A new investment was made in Huntington Ingalls (HII).

Huntington Ingalls, Inc. is the largest independent military shipbuilder. Ships, the longest cycle defense product, take years to manufacture, and are typically purchased in blocks to reduce unit cost. The extended time required to build a ship means that funding for a project is difficult to cut and the block purchase aspect gives Huntington substantial visibility into the progression of revenue. Huntington Ingalls' top line is, therefore, less sensitive to changes in the defense budget than peer contractors, making it what we believe to be a more defensive play. We also view geopolitical developments, specifically naval military expansionism in China and Russia, as major concerns for Western governments and as such we remain highly bullish for ship and submarine manufacturers, namely HII.

As central banks now seek to extricate themselves from capital market dominance, the entire yield curve is showing signs of volatility. We think these disruptions will be episodic as different countries and regions act and react on different timelines to inflationary pressure not seen in many years. We have long believed that committing your capital to a fixed income stream became imprudent several hundred basis points ago. We remain defensive and seeking stable, growing cash flows into the portfolio.

Behavioral Finance

Returning to the question on risk, behavioral economists believe financial activities are influenced by irrational emotions instead of the rational decisions assumed by traditional 'efficient market' theory. Evidence from the great financial crisis of 2007/08 supports the behavioralists' conclusions, as efficient market models collapsed in a hard landing that destroyed trillions in paper wealth. This greed-and-fear dynamic suggests that markets follow emotional cycles, although the course is not readily predictable. If so, given where we currently are in the emotional cycle, after the extended period of positive returns, greed is a well-entrenched bias in today's financial arena. Small changes in the market's assessment of factors like growth, interest rates and justified valuations could have large implications for prices, as evident in market returns in the first few weeks of 2022. To us, this suggests risk should be a major consideration in portfolio construction.

Risk management has always been a hallmark of our strategies. The brutal math of recouping losses is what drives this emphasis. As we begin 2022, we remain focused on building portfolios of what we consider to be great businesses with favorable risk characteristics across the growth, value, and market capitalization spectrums.

As always, thank you for your business; please reach out any time with any issue.

Jeffrey Lent
January 12, 2022

Q4 2021 Top Contributors & Detractors

Security	Sector	% Avg. Weight	% Contribution
Broadcom Inc. Pfd Series A	Info Tech	4.6	+1.5
Qualcomm Inc	Info Tech	4.2	+1.5
KLA Corporation	Info Tech	4.3	+1.1
Home Depot, Inc.	Cons Disc	4.4	+1.1
AbbVie, Inc.	Health Care	3.9	+1.0
Comcast Corporation Class A	Comm Services	3.5	-0.4
Huntington Ingalls Industries, Inc.	Industrials	2.4	-0.3
SLM Corp Non-Cum Pfd Series B	Financials	4.3	-0.2
JPMorgan Chase & Co	Financials	3.8	-0.1
Cummins Inc.	Industrials	3.3	-0.0

Q4 2021 Top 10 Holdings

Security	% Holdings
Amgen Inc.	5.3
Broadcom Inc. Pfd Series A	5.2
Lockheed Martin Corp.	5.0
Paychex, Inc.	4.9
LyondellBasell Industries NV	4.7
Home Depot, Inc.	4.6
Qualcomm Inc.	4.6
KLA Corporation	4.5
Genuine Parts Company	4.3
Abbvie, Inc.	4.2
Percentage of total portfolio	47.3

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 bscalise@torray.com.

The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values. The S&P 500 measures the value of stocks of the 500 largest corporations by market capitalization listed on the New York Stock Exchange or Nasdaq Composite. You cannot invest directly in an index.

Dividend changes represent past activity and there is no guarantee dividends will continue to be paid.

Total returns include the reinvestment of dividends and other earnings. **Investing involves risk; principal loss is possible. Past performance is not indicative of future results.**

Source: FactSet and Torray LLC.