Torray
INVESTMENT PARTNERS

Q3
2023

Small/Mid Cap Growth Strategy (SMID)

Quarterly Commentary

Portfolio Update

We continuously search for investment opportunities benefiting from secular growth tailwinds. Artificial Intelligence (AI) is emerging as a significant technology enabling innovations with the potential to affect all industries, akin to the decades-long PC, internet, and smartphone trends we have previously experienced. As we survey the AI ecosystem at this stage of adoption, separating the opportunities from vulnerabilities is critical to our risk-managed approach. While the build-out of AI-related products is driving current demand for semiconductors, hardware, and infrastructure, software companies that add AI functionality might be among the biggest long-term winners.

The SMID portfolio sold traffic solutions firm **Verra Mobility (VRRM)** following the abrupt resignation of their auditor and change in senior management. We take financial controls seriously and have serious reservations when a company has potential accounting irregularities. The sale realized a capital gain, but we plan to continue evaluating VRRM if these issues are addressed in the future.

The Importance of Dividends

The value of a financial asset is the present value of its future cash flows, and the only cash flows an equity owner will receive are dividends (unless they sell the stock). Therefore, an investor must forecast dividends to handicap a stock's risk/return profile accurately. While Torray uses the current dividend as one indicator of business strength, we emphasize the potential for future dividends. Characteristics favorable to this potential that attract us include recurring, non-cyclical revenue streams, competitive advantages, management's track record with reinvestment opportunities, and prudent balance sheet deployment. We try to avoid the stocks of businesses lacking the ability to pay future dividends.

Some investors view dividends as a signal that a company's growth prospects are behind it. However, that is not always the case. We believe companies that pay dividends must ensure they only allocate capital to projects that will earn attractive returns, while actively avoiding those that do not. This is especially important in a rising rate environment. Over the long term, this discipline provides more robust, higher-quality growth profiles, especially from a consistency perspective. Dividends and the potential for dividend growth might also mitigate the downside during periods of market stress, all else being equal. Therefore, a diversified portfolio across dividend-paying companies and those with the ability to pay dividends in the future has the potential to lower risk and improve returns over time.

Market Commentary and Outlook

The equity market, as measured by the S&P 500® Index, dropped 3.3 percent in the third quarter, a modest decline as the bullish sentiment that fueled that market's rally over the past twelve months faded. The S&P 500® is still showing impressive twelve-month gains, up 21.6 percent. Investors are responding to inflation indicators and related Federal Reserve comments and policy. With concern, we note that the yield curve has been inverted for a record number of consecutive months. In our view, this is an unhealthy clue that economic activity is slowing. It also presents structural challenges to traditional financing models. Against this, we remind clients that market-based economies typically adapt to change and risks successfully. Over time, we believe stable policy (fiscal, regulatory, and monetary) will aid in the favorable resolution of the current cycle.

We do see potential problems looming that could be more difficult for the market to adapt to should they materialize. For example, last quarter, we discussed the rising risk of Chinese economic decoupling. Another concern is the historically large amount of market capitalization represented by just a handful of household mega-tech names (just seven stocks represent nearly fifty percent of major large growth indexes and nearly thirty percent of the S&P 500). If one or two of these companies experience a misstep, it could trigger a vicious circle of selling that will have a disproportionately negative impact on the entire equity market. We are attempting to reduce exposure to these risks prudently.

[1] The S&P 500® Index measures the value of stocks off the 500 largest corporations by market capitalization listed on the New York Stock Exchange or Nasdaq Composite. Past performance is not indicative of future results.

Best and Worst Performers in the Quarter

Top Contributors	Top Detractors
Vicor Corporation	Lantheus Holdings
Tradeweb Markets	Blueprint Medicines
Aspen Technology	Cooper Companies
Qualys	Entegris
Ryan Specialty Holdings	Monolithic Power Systems

Reflects the top five holdings that contributed to and detracted from composite performance listed in descending order. Specific securities identified do not represent all the securities purchased, sold, or recommended for the strategy. A contribution analysis list of all holdings and calculation methodology information are available upon request. Do not assume any securities identified were or will be profitable. Past performance is not indicative of future results.

Why Consider Torray Investment Partners as Your Small/Mid-Cap Growth Solution?

A Singularly Focused Investment Firm

OUR CULTURE

Independent, Stable and Client Centric

Broad-based active equity ownership bound by a partnership mentality drive tight alignment with our client's long-term interests.

OUR APPROACH

Risk-Managed, Concentrated Investing

For more than 50 years, we've built active portfolios based on our research-driven conviction in the relatively few businesses able to create economic value for shareholders.

OUR STRUCTURE

Institutional-Quality Boutique

Unburdened by bureaucracy, we are more creative and agile in efforts to deliver exceptional client service and consistent long-term risk-adjusted performance.

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