THE VIEW FROM THE SUMMIT

REBALANCE COMMENTARY

During the most recent rebalance, our rigorous quantitative process helped us identify several new candidates for the portfolio as well as identify several sale candidates. Specific stocks are listed below. The rebalance slightly de-risked the portfolio and resulted in approximately 5% turnover while also improving our overall portfolio alpha score. As part of our investment process, all new candidate companies undergo a fundamental risk rating process which focuses on downside risk. Companies not passing our fundamental analysis criteria are excluded.

In terms of factors, the largest changes were (1) a reduced exposure to the size factor (2) a reduction in dividend yield (3) a reduction in volatility (4) a reduction in exposure to the leverage factor, and (5) an increased exposure to the momentum factor. In terms of sectors, the largest changes were (1) a slight increase in exposure to the Technology, Industrials, and Materials sectors, and (2) a slightly reduced exposure to Telecom Services, Financials, and Healthcare sectors.

Finally, the rebalance resulted in the following portfolio characteristic changes (1) a reduction in the dividend yield and debt-to-equity ratio, and (2) a slight increase in the price-to-earnings, price-to-cash flow, and price-to-book ratios

RECENT STOCK ACQUISITIONS

Intuitive Surgical Inc. (ISRG, $418.88, 1.04% weight) is a $47B market cap company based in Sunnyvale, CA that designs, manufactures, and markets surgical tools and systems including robotically aided surgery systems. Customers include the Mayo Clinic, Johns Hopkins, and other premier health care systems. More than 70% of sales come from the U.S. while the remainder comes from Japan, South Korea, and Europe. The company trades at an expensive valuation of 43x this year’s earnings of $9.75 per share, however, growth is strong with revenues expected to grow +13% and EBITDA to grow +15% this year. The company generates nearly $1 billion of free cash flow annually. The President and CEO, Dr. Gary Gutharth, has run the company for 8 years but has been on the executive committee since 2006. In addition to a strong quantitative alpha score, a thorough fundamental review of the company displayed no “red flags” regarding litigation risk, business deterioration, industry competition, regulatory risks, management quality, or numerous other idiosyncratic factors.

Mastercard Inc. (MA, $174.17, 1.01% weight) is a $184 B market cap company based in Purchase, NY. It is the number two payment system in the U.S., behind Visa, which serves more than 20,000-member financial institutions around the world. The company does not issue credit cards, rather, it markets the Mastercard, Maestro, and Cirrus brands to provide payment transactions and collect fees. The U.S. is the largest market accounting for 40% of revenues while no other country exceeds 10% of revenues. The company trades at a premium valuation of 29x this year’s earnings and a dividend yield of 0.57%. Revenues and earnings are expected to grow +16% and +30% this year while generating a return on invested capital of over 35%. The company went public in 2006. President and CEO, Ajay Banga, has run the company for the past 10 years. In addition to a strong quantitative alpha score, a thorough fundamental review of the company displayed no “red flags” regarding litigation risk, business deterioration, industry competition, regulatory risks, management quality, or numerous other idiosyncratic factors

Roper Technologies Inc. (ROP, $273.76, 1.47% weight) is a $28 billion market cap company based in Sarasota, FL that manufactures and distributes industrial equipment including industrial controls, fluid handling, pumps, and analytical instrumentation products. The company has grown both through numerous acquisitions as well as internal organic growth. The company trades at a reasonable valuation of 25x this year’s earnings of $10.93 per share with a small dividend yield of 0.60%. Revenue are expected to grow +6% this year, earnings are expected to grow +16%, and EBITDA is expected to grow +7%. Free cash flow generation is likely to exceed $1,246M in 2018. The Chairman/President/CEO, Brian Jellison, has been running the company for over fourteen years and owns over 1.5 million shares personally. In addition to a strong quantitative alpha score, a thorough fundamental review of the company displayed no “red flags” regarding litigation risk, business deterioration, industry competition, regulatory risks, management quality, or numerous other idiosyncratic factors.

THE VIEW FROM THE SUMMIT

RECENT STOCK SALES

Broadcom Inc. (AGVO, $240.72, Sold, formerly 0.21% weight) is a $98 billion market cap company based in San Jose, CA that designs, develops, and markets digital and analog semiconductors for wired infrastructure, wireless communications, enterprise storage, and industrial segments. The stock has been a phenomenal success rising over 140% from a 2016 low price of $116.31 to a 2017 high price of $284.62. While there were no identifiable fundamental weaknesses in Broadcom, our rigorous quantitative process generated a less attractive alpha score versus other technology holdings. Likely, the risk/reward trade off combined with a rising stock volatility made this company less quantitatively attractive than other candidates. We sold the stock according to our sell discipline.

Kroger Co. (KR, $23.56, Sold, formerly 1.04% weight) is a $20 billion market cap company based in Cincinnati, OH that operates 3,900 supermarket and convenience stores in the U.S. Although trading at an attractive valuation of only 11x this year's earnings per share of $11.36 and a dividend yield of 2.13%, the company has had difficulty generating any earnings growth in recent years. The stock dropped from a high of $31.34 in January to a low price of $22.98 in March after the company announced margin pressures in the 2018 outlook and weak earnings from the prior quarter. While there were no identifiable fundamental weaknesses in Kroger, our rigorous quantitative process generated a less attractive alpha score this month. Likely, the risk/reward trade off combined with a rising stock volatility made this company less quantitatively attractive than other candidates. We sold the stock according to our sell discipline.

Regency Centers Corp. (REG, $58.98, Sold, formerly 0.21% weight) is a $10 billion market cap self-administered and self-managed real estate investment trust based in Jacksonville, FL that owns and operates grocery anchored retail centers. The company trades at a reasonable valuation of 15.6x this year's funds from operations and a 3.76% dividend yield. However, the stock has been steadily declining since June 2016 as all retail REITs began to underperform the market. While there were no identifiable fundamental weaknesses in Regency Centers, our rigorous quantitative process generated a less attractive alpha score this month. Likely, the risk/reward trade off combined with a rising stock volatility made this company less quantitatively attractive than other candidates. We sold the stock according to our sell discipline.

We remain optimistic about this rebalance and the opportunities within the U.S. equity market, and we remain focused on monitoring the risk of individual companies as well as the overall portfolio. During these times of continued uncertainty, we believe the strategy will continue to provide a managed risk approach to equities, seeking the return of equities with significantly lower overall risk.

Sincerely,

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