Spring 2021

Trend Talk

How Oak Ridge's Search for High Quality Businesses Leads to the FAAMG Stocks

Oak Ridge All Cap Growth Portfolio

How did FAAMG stocks end up in the Oak Ridge All Cap Growth Portfolio?*

Because the FAAMG stocks meet the investment criteria central to the Oak Ridge investment process and in today's market are "Oak Ridge" types of companies:

a) **Solid, high quality business**—The FAAMG stocks represent firms that are growing organic sales faster than GDP and sector/industry alternatives. These companies have the potential to continue to take market share, and benefit from a number of favorable secular tailwinds that Oak Ridge anticipates will continue. The portfolio management team uses the Russell Growth indices (the Russell 3000 Growth Index for the All Cap Growth Portfolio) as a guide, but is generally diversified across sectors and industries with any overweights naturally generated through their fundamental bottom-up focused process.

b) **Instills confidence in expected fundamental growth**—In their view, Oak Ridge is not a macro-driven investor. The future is always very unpredictable in their world (COVID-19, U.S. presidential elections, etc.) Consequently, they try to remove as many economic/cyclical variables from their investment process as possible by focusing on trailing fundamental execution of sales, cash flows, and earnings based on consistency. They avoid most cyclical stocks in favor of recurring revenue service-driven type businesses.

c) **Oak Ridge uses a company's 3-5 year trailing performance as 'a' measure (as opposed to 'the' measure) of management's ability to execute, and as a gauge of the strength of the business's underlying competitive advantage to give them confidence in how they frame their assumptions and forecasts**

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Rob McVicker has been managing the Oak Ridge All Cap Growth Portfolio since its inception 20 years ago. Utilizing fundamental bottom-up, high-conviction research and a repeatable investment process, Rob focuses on finding high-quality, differentiated companies that may provide investors attractive long-term returns. Ultimately his goal is to achieve superior returns over a full-market cycle while taking less risk. The Portfolio's concentration in small, mid and large cap names will ebb and flow over time. At this moment in time, Rob's process leads him to the FAAMG stocks—Facebook Inc. (FB), Apple Inc. (AAPL), Amazon.com Inc (AMZN), Microsoft Corp. (MSFT), and Google, now called Alphabet Inc. (GOOGL). Here's how and why.

* A copy of the complete All Cap Growth Portfolio and its performance is available upon request from Oak Ridge Investments: (312) 857-1040.

underpinning each investment case. Visibility and predictability of the business is their primary focus and instills confidence they understand the business and can make reasonably confident estimates of the company's future growth rates.

d) **Valuation/RISK—the focus is risk-adjusted returns**. The team would ideally like to take less valuation risk to achieve in-line to better returns than the index over time. Based on their focus on typically solid business enterprises with good fundamental visibility, they would prefer to incorporate conservative expected growth rates and at reduced valuations and still expect similar or potentially even better returns relative to the index over time.

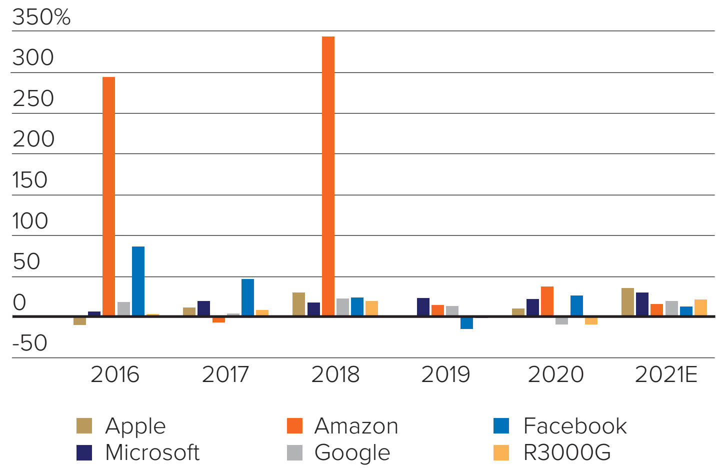
But aren't the FAAMGs expensive?

a) **It's hard to argue FAAMG aren't "the best of the best."** Even though the companies are massive they incorporate large addressable market opportunities and continue to generate great organic revenue growth and take market share. They all generally have monopoly-like characteristics in their various fields. It's hard to see their businesses changing materially in the near to intermediate term. Although potential action by the U.S. Congress is a wild card, having seen these companies in action over the years, it seems more likely to expect fines/regulation well after the business has moved on. But there is an outside chance of a break up of one or two of these companies and that is a concern the team monitors closely.

b) **Trailing 5-year EPS Compounded Annual Growth Rate (CAGR) at March 31, 2021 ranged with AAPL at 16%, GOOGL at 22%, MSFT at 15%, and FB at 22%, Trailing 5-year Sales/CAGR FB at 31%, and AMZN Sales/CAGR at 28%**. Oak Ridge's research concludes that the factors that support these prior growth rates remain the same, or in many instances, are even strengthened, such that Oak Ridge thinks that they can sustain or even accelerate their growth rates, in most instances. The historical delivery of growth and profitability further underpins their confidence in future delivery.

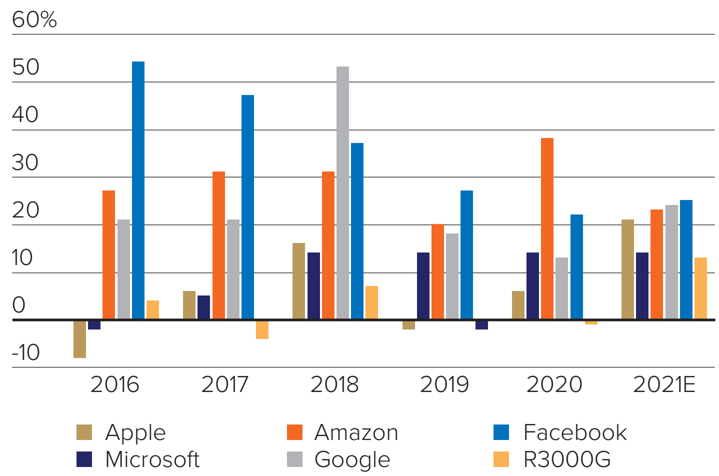
c) **Currently the Russell 3000 Growth's P/E valuation is in the high 30's. Based on our expectations for earnings, Oak Ridge believes these stocks should trade in a range similar to the benchmark**. (This makes sense as

EARNINGS GROWTH (%) AS OF 3/31/21



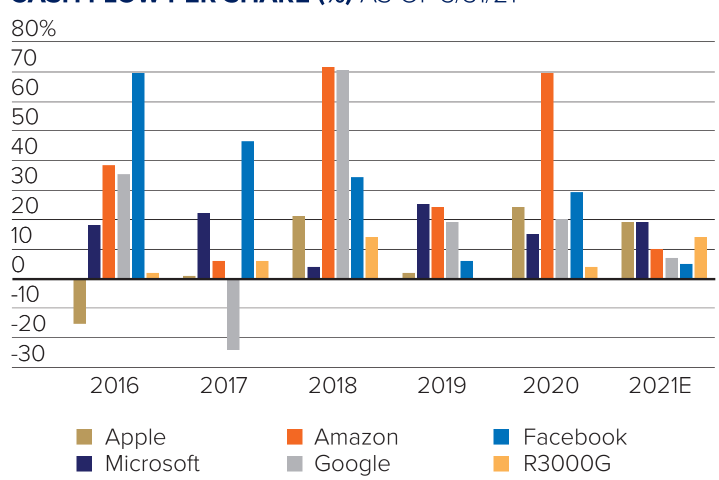
Source: FactSet E = Current estimated value for the calendar year 2021.

SALES GROWTH (%) AS OF 3/31/21



Source: FactSet

CASH FLOW PER SHARE (%) AS OF 3/31/21



Source: FactSet

FAAMG are currently about 35% of the Russell 3000 Growth Index.) An observation: valuation of the Russell 3000 Growth Index is up a bit over the last five years (based on P/Es) and likely a bit stretched, depending on one's metrics, over historic norms. This doesn't mean outsized returns can't happen, it only means longer-term it would likely be prudent to expect <10% index returns. By comparison, the FAAMG stocks are also a bit higher in valuation (based on P/Es) over the five years, but Oak Ridge would argue it is well supported from their superior trailing fundamentals. Finally, the FAAMG and the R3G index are currently trading at similar valuations, yet the team feels the trailing fundamentals have been superior and even with conservative expectations should continue to generate superior growth rates.

ALL CAP GROWTH PORTFOLIO VS. RUSSELL 3000 GROWTH*

	All Cap Growth Portfolio	Russell 3000G	FAAMG
Sales Growth 3 Years (LTM)	17.57	18.14	20.76
EPS Growth 3 Years (LTM)	21.34	22.46	22.46

Source: FactSet

*The metrics used in this table are trailing/rolling twelve months (LTM) Sales Growth, Operating Cash Flow (OpCashFlow) and Earnings Per Share (EPS) Growth.

Based on scarcity of growth in other names, the assumption of a low GDP backdrop, and low rates, the team believes these valuations are acceptable based on their relative confidence in the stocks' probability for delivering and visibility.

Although the future is unknowable, the Oak Ridge team seeks to buy the best high-quality businesses with visible/predictable fundamentals and at reasonable valuations. The FAAMG generally fit this criteria across the board:

- The team believes the expansion in valuation of the FAAMG names are supported by superior trailing/expected growth rates (per FactSet) and worthy of their headlines.
- Work from home may be an additional secular tail wind, but even without that, the team is confident in the business trends continuing.
- Due to these companies' market caps, a more discounted expected growth rate based on trailing results seems prudent.
- Even so, Oak Ridge believes FAAMG should continue to generate superior fundamental growth versus the average stock in the index. So, while paying for a similar valuation the team feels the very high quality of these business enterprises should continue to generate superior growth rates.
- The team could buy faster growing companies, but would likely assume a higher risk profile. Why do that? Ideally they would prefer to generate in-line to index-beating returns while taking as little risk as possible. The FAAMG's are an example of what Oak Ridge believes this kind of opportunity.
- **As this fundamental picture changes and Oak Ridge perceives these stocks lose their investment appeal to other alternatives with better valuations and better more visible growth prospects, the team will adjust the portfolio accordingly. As Oak Ridge has been doing for over 30 years.**

For more information about the Oak Ridge All Cap Growth Portfolio or how we can put our experienced and we believe exceptional investment team to work on behalf of your clients, please do not hesitate to contact us at (312) 857-2160.

As of March 31, 2021, the FAAMG stocks held by the Oak Ridge All Cap Growth separately managed accounts model portfolio represented the following percentages of total portfolio assets:

Apple 11.8%
Microsoft 10.8%
Amazon 8.2%
Facebook 6.2%
Alphabet 6.2%

The Portfolio is actively managed and current holdings and characteristics may be different. The holdings listed or discussed in this document should not be considered recommendations to buy or sell any particular security listed. Actual portfolio holdings and weightings may vary depending, among other reasons, on the separately managed account size, cash levels and cash flows within an account, timing of account execution, and restrictions on an account.

Benchmark Information: The Russell 3000 Growth Index measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. The model portfolio will differ significantly in terms of holdings, industry weightings, and asset allocation from these indices. Returns and volatility of the model portfolio may differ from these indices. The returns for any index include the reinvestment of dividends or interest. Indices shown are unmanaged and are not subject to fees and expenses typically associated with investment vehicles/accounts.

Other Disclosures: The information presented is for the separately managed model portfolio and is for illustrative purposes only. The information in this document does not represent a recommendation to buy, hold or sell securities. Investment in securities entails risks, which may include but are not limited to equity portfolios being subject to the basic stock market risk that a particular security, or securities in general, may decrease in value and the stocks of small and medium-sized companies are often associated with higher risk than stocks of larger companies, including higher volatility. Investment advisory programs may require a minimum asset level and, depending on an investor's specific investment objectives and financial position, may not be suitable for all investors. Please consider the investment objectives, risk, charges, and expenses of the program carefully before investing. Oak Ridge Investments' Form ADV contains this and other important information about separately managed accounts managed by Oak Ridge Investments, LLC. Please read the Form ADV carefully before investing.

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