SWS Growth Equity

Strategy Update as of March 31, 2020

Firm Overview

SWS Partners is a registered investment advisor that focuses on using technology to deliver contemporary asset management and financial planning solutions to high net worth individuals, family offices, endowments, foundations, and other institutions. We believe that by emphasizing the application of modern technologies, we can create broad efficiencies and deliver better outcomes to clients.

Strategy Info

Inception	May 1, 2018
Benchmark	Russell 1000 Growth Index
PM	Michael Parker, CFA

Strategy Objective

SWS Growth Equity seeks to create long-term capital appreciation by investing in companies across multiple industries that have the ability to maintain or take a profitable market share.

Portfolio Manager

Michael Parker, CFA, is the CIO of SWS and portfolio manager for the SWS Growth Equity strategy. Before joining SWS in 2017, Mike was a portfolio manager of $4 billion of long-only equity portfolios at the Ohio Public Employees Retirement System (OPERS). He leverages over seventeen years of experience on both the buy-side and sell-side to bring an institutional research and portfolio management framework to SWS Partners.

Prior to OPERS, Mike was responsible for investment bank equity research at FBR Capital Markets. He received his bachelor of science in economics, finance concentration, from the Wharton School at the University of Pennsylvania and is a CFA® charterholder.

First Quarter Update

A common perception of active management is that gains are easy with the presence of a market tailwind. Ultimately, whenever a correction rears its ugly head, performance erosion ensues and takes with it casualties of previously-achieved upside and some degree of principal impairment. Additionally, the notion that growth-style equity will bear disproportionate strain relative to its value counterpart in environments of market turmoil typically accompanies this view. We built SWS Growth Equity to disprove all of these. While establishing proof points along its nearly two-year existence of public availability, 1Q2020 results provided the strongest testament to date of the strategy's execution by design amidst the most challenging systemic disruption since the financial crisis.

These criticisms of active management are well deserved at the aggregate level. A continued mass exodus to passive strategies has shown little signs of abatement, with the main driver being inferior outcomes delivered by the average active experience relative to passive strategies. However, investors should not have to settle for average, and superior outcomes can exist. They just require a differentiated approach in order to maintain any hopes for sustainability. Our goal with Growth Equity is to provide outperformance on rolling three-year periods for all strategy investors, regardless of what the market throws our way and regardless of client inception. By structuring portfolio bets for relative value creation, we take an agnostic stance on market directionality, with the goal of better insulation on downside capture without foregoing upside participation. The delivery mechanism to this is institutional-grade risk management, carried forward from a decade of managing capital within a large institution.

To put some context behind the market correction endured in the first quarter, the speed of its arrival was nearly 4x faster than any prior recession since the 1960s (as we highlighted last month). In total, the S&P 500 had $10 trillion of market cap eroded amidst its 34% plummet in a little over a month. As globally coordinated efforts scrambled to stem COVID-19 incidence and avoid overtaxing healthcare systems, the US federal government arranged $6 trillion of total stimulus (to which we took a stab at context) in an attempt to mitigate economic impairment from various regional shut-downs. As we enter phase two of pandemic response, we see various components to our thesis playing out, namely enabling increased pandemic response precision while making progress with therapeutics and immunizations. In a nutshell, humanity has never had the advanced scientific and technological tools at its disposal to deconstruct the molecular blueprint of the “invisible” threat that is SARS-CoV-2.

That said, our confidence in identifying business models poised for relative valuation creation—aka the crux of sustainable alpha delivery—is far greater than our ability to call market bottoms. Observations of the latest evidence of fundamental data from underlying issuers continues to suggest that the worst may be behind us (see “Our Market Take” on pg 8). Since this exercise requires pricing forward expectations, a one-third haircut to blue chip market cap already contemplates draconian scenarios for 2Q and 3Q2020 earnings and ultimately economic output. By definition, economic indicators in the coming weeks/months undoubtedly will confirm the deterioration that the 36% price adjustment has already contemplated. We also will need to brace for the morbid reality of this particular risk factor, as deaths inevitably follow our global march towards three million confirmed cases. That is an extreme burden for risk-based assets to bear, but such has been the case in every systemic challenge thrown our way.

History has well documented the Achilles heel of investor behavior during systemic disruptions: mental anchoring precludes the ability to see the path past the cloud of fear. Being able to conclude with reason that a given disruption indeed is not the end of days, and that the gears to economic output will again turn, typically provides the vast majority of evidence one needs to pierce through the veil of uncertainty. We are firmly in the camp that economic recovery is inevitable. It just so happens that the same business models well poised to execute digital transformations across all industries—ones that populate our Growth Equity portfolio—are also providing the critical tools to navigate this pandemic. We see many of these trends as sustainable accelerators rather than one-time demand pull-forwards, which bodes well for continued relevance to our investment process in the quarters and years to come.

Consumers undoubtedly will stock up on various staples to aid in abiding by sheltering orders. This is sure to create air pockets of demand for various goods in the months to follow, e.g. aggregate toilet paper consumption shifts will leave an absence of buying once household shelves contain months of supply versus their prior weeks’ cache. However, other more prolific and sustainable trends are taking root. Business model shifts in healthcare to telehealth delivery, in call centers to remote servicing, in restaurant and retail to curb-side pick-up, in real estate to electronic closings, and in all businesses to online fulfillment are use cases that are unlikely to revert to their prior states. These are all themes that we are long in size across our Growth Equity portfolio. We view this as a compelling bridge over challenging waters of a pandemic response, one that will remain well poised for whenever we definitively reach the other side.

Raison D'être: Alpha Delivery

Versus our Russell 1000 Growth Index benchmark, Growth Equity fared better in the first quarter draw-down, netting a -12.30% total return gross of fees, relative to the -14.10% result in our index. Due to higher exposures in financial services and energy, the S&P 500 posted a 19.6% decline in the quarter. Peak-to-trough, the S&P 500 marked a 33.9% decline from February 19th through March 23rd, as daily confirmed COVID-19 cases went from hundreds to thousands in the US. Once congress and the Fed implemented stimulus programs, and steepness of daily increases began to hint of flattening on the horizon, the last week of the quarter recaptured some losses. Thus far into April, we are maintaining our relative upside posture, while the Russell 1000 Growth Index has recovered 7.0% on the month.

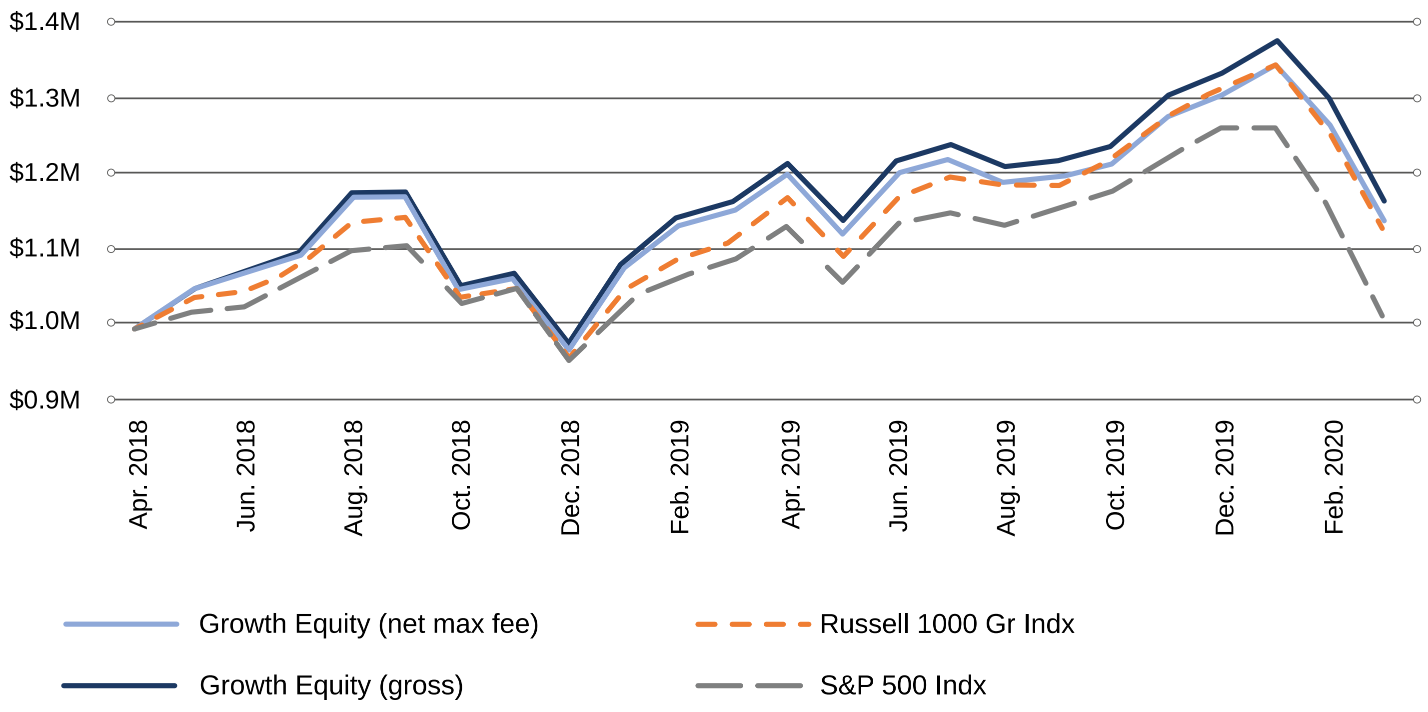
Taking a wider snapshot of results since our strategy's May 1, 2018 public availability inception, we continue to deliver on long-term upside capture. Additionally, growth style proxies deliver evidence of continued bifurcation that we've highlighted in prior white papers. Growth constituents tend to be populated by higher proportions of companies aiding in the delivery of an increasingly digitized future. This underlies our argument that asset class exposure here is imperative for long-term oriented investors.

Chart 1: SWS Growth Equity Performances as of 3/31/2020

	1Q2020	1-Year	Since Inception (Annualized)	Since Inception (Cumulative)
Growth Equity (net max fee)	-12.58%	-1.16%	6.96%	13.76%
Growth Equity (gross)	-12.30%	0.09%	8.31%	16.53%
Russell 1000 Growth	-14.10%	0.91%	6.44%	12.69%
S&P 500 (reference)	-19.60%	-6.98%	0.63%	1.21%

Please see performance disclosures on page 10. Growth Equity inception 5/1/2018.

Chart 2: Growth of $1 Million in SWS Growth Equity Since Inception



Above chart displays the value of a hypothetical $1 million investment in SWS Growth Equity since its May 1, 2018 inception, both on net of maximum advisory fee and gross of advisory fee bases. These results are compared with broad-based indices, which do not include expenses, and are shown on a total return basis with dividends reinvested.

Chart 3: Equity Indices 1Q2020 Total Returns

Russell 1000 Growth:	-14.10%
S&P 500:	-19.60%
Russell 1000 Value:	-26.73%
Russell Midcap:	-27.07%
Russell 2000:	-30.61%
NASDAQ Composite Index:	-13.95%

Source: FactSet. Data represent total return (dividends reinvested into respective index) for the period 12/31/2019-3/31/2020.

Contributors & Detractors

The following analyses highlight the fundamental work underlying our investment process. One the next page we deconstruct the merits of the top contributors and detractors to portfolio performance on the quarter (with total return contributions listed):

Top Contributor

Netflix, Inc. [NFLX]: +16.0%

A confluence of factors have caused Netflix to fare better during 1Q than many of its media and publishing cohorts within consumer discretionary. The most obvious is the increased streaming hours from consumers abiding by stay-at-home orders. However, other aspects of Netflix's pure-play streaming business model are playing out in terms of portfolio construction. For example, not having the capital intensity of maintaining fiber and coaxial footprints like its cable cohorts translates into lower balance sheet burdens. Additionally, not having the expensive infrastructure of entertainment theme parks, cruise lines, and movie production studios (budgeted for theater box office releases), as Disney does, brings into light risks associated with going long DIS stock solely due to its Disney+ streaming launch. The latter has been on a drag on NFLX shares due to the misperception of winner-takes-all in the streaming wars. However, we continue to see tremendous upside in entertainment wallet spend on a service costing $13/month in the US, one that now addresses a global marketplace of increasing quantities of broadband subscribers. First quarter results published on Tuesday evening confirmed that NFLX is a net beneficiary of the current environment, with all geographic regions showing accelerations in paid net additions. Since 2019 marked the trough of adverse cash flow impacts, an artifact of ramping Netflix Original content that began five-years ago, higher platform utilization will also accelerate Netflix's plans towards highly sticky, long-term cash generation.

Top Contributor

NVIDIA Corp. [NVDA]: +12.1%

NVIDIA pulled a repeat top-contributor performance in 1Q after a strong relative result in the prior quarter, mainly as continuation of the themes outlined in our last quarterly. The same compute workloads that are shifting from on-premise data centers to cloud architectures that are pulling demand for NVIDIA parallel compute silicon along with it arguably become enhanced during the current environment. Online retailers that have been noting surges in demand all rely upon outlets like Google Cloud Platform, Amazon Web Services, and Microsoft Azure to keep pace with uplifts in compute demand. Scale-out architectures that deliver many services behind these platforms are precisely down the demand fairway that NVDA plays. What was previously a call-option segment behind NVDA's core GPU gaming business is now nearing $4 billion/year in revenue growing 40%+ YoY. The paradigm shift to these workloads includes architectures that enable the neural networks of machine learning to write their own lines of code, along with many other use cases that fall underneath the autonomy umbrella. As such, we continue to like NVDA's relative posturing among other semiconductor players and broadly within our technology exposure.

tapestry

Top Detractor

Tapestry [TPR]: -50.7%

There were few places to hide in anything retail-oriented during the first quarter. This sub-sector of consumer discretionary affords us the opportunity to bargain hunt unloved names that are prone to cycles of favor. Such was the case that we identified with Tapestry, i.e. the parent to Coach, Kate Spade, and Stuart Weitzman brands. We saw an opportunity for fashion brands with largely mutually exclusive customers to optimize digital go-to-market strategies, to increase under-indexed Asian exposures, and to revitalize an asset that poorly managed its inventory in retail and discount channels. As painful as the headline price reaction suggests, our hedge of relative under-weights within brands/retailers is helping to soften the relative contribution. Index constituents faring worse included Capri Holdings [CPRI] and Under Armor [UA], with -71.7% and -58.0% returns, respectively, while Hanesbrands [HBI] and VF Corp [VFC] held up better but still posted stressed results of -46.0% and -45.3%.

As we observe Coach's stand-alone results during the '08/'09 financial crisis, we see its worst performing quarter posting a 2% YoY sales decline, as affordable luxury typically resonates as a retail therapy outlay. With a far better online presence than 11 years ago, Tapestry heads into this environment with better abilities to meet online demand shifts while having a balance sheet capable of enduring the current challenge. Brand revitalization of Kate Spade indeed has been prolonged, resulting in executive management shuffles. However, having a long-time board member, who's also a former Goldman investment banker, at the helm increases odds for economic value creation, which we believe is underappreciated at current price levels. The shares' 25% recovery off its recent bottom to us indicate how overdone the sell-off has been. As such, we continue to like our relative posturing in this segment of consumer discretionary and have the bandwidth to retain TPR as a distressed name with long-term upside.

BOEING

Top Detractor

Boeing [BA]: -49.6% through 3/12/2020 position exit

Thesis evolution is inevitable. Since perfect visibility is impossible, the key is to retain response adaptability when thesis impairment news requires it. Such was the case with Boeing during the quarter. We covered the merits to our long thesis in the context to 737 MAX return-to-service efforts within our 4Q2019 quarterly. Capital intensity is not a barrier-to-entry per se. However, the duopolistic structure of commercial aircraft manufacturing has made it nearly impossible for Boeing's order backlog to shift to Airbus in light of the software bug that has plagued Boeing's MAX program. We were anticipating a return-to-flight during 2020, which still appears plausible. However, massive curtailment of airline flight miles in light of global travel shut-downs is a hefty blow yet to be revealed within Boeing's order book. Additional headline risk of airline bankruptcies could weigh on the company and cause focus to shift

Boeing continued...

towards its balance sheet leverage of $28.5 billion in total debt and currently negative EBITDA. Five-

year CDS spreads on Boeing have also ballooned: they ended February at 78 bps and now cost over 300 bps, representing a 562% increase over the prior six months. Subsequent to our mid-March position exit, Moody's and S&P downgraded Boeing debt to the lower tier of investment grade, while assigning a negative watch/outlook to its issuance. Due to the structure of this industry and the attractive demand for aviation in the coming years, it's likely that we will revisit the stock down the road. However, all these conditions suggest that the opportunity cost of owning BA in the coming quarters is too high, and as such we redeployed proceeds to other areas of producer durables, namely Roper Technologies [ROP] and Honeywell International [HON].

Top Detractor

Visteon Corp. [VC]: -44.6%

Visteon moved from a top 3Q2019 performer to a top 1Q2020 detractor, as the entire automotive supply chain showed strains from initial Chinese factory shut-downs during the earlier phases of global COVID-19 contagion. With global light vehicle production targeting a 94 million unit per year opportunity, latest estimates now contemplate an opportunity closer in to 86 million, with further downside likely due to the pandemic. This challenged end-unit backdrop is precisely what led us to identify participants capable of delivering content growth and market share gains in light of a shrinking global unit pie. Visteon's focus on cockpit digitization and increased infotainment penetration continues to deliver disproportionate success on this front; for example, VC's overall 4Q2019 results outperformed automotive production by 700 bps. Results unfortunately face a tough backdrop that indiscriminately punishes all participants. Within automotive, low-30% to high-40% declines were experienced across suppliers, parts retailers, and used car sales outlets, helping to hedge our relative exposure in this segment of our consumer discretionary book. The pillars to our fundamental thesis that we outlined in our 3Q2019 quarterly remain intact, and the secular themes that we were able to delve further into with Visteon management at CES in January should deliver outsized relative results for the company. As such, we continue to like our relative exposure for this segment of the portfolio.

Our Market Take

As mentioned in the intro, our daily lives are fully consumed by all aspects of the same risk causing disruptions in the equity markets. This is yet another “first” for our modern era, as prior systemic disruptions were largely perceived to be confined to financial services balance sheets (2008/2009) or among technology cohorts (2001/2002). Every single human on this planet is aware of the daily sacrifices necessary to navigate today’s dislocation. This makes the task of sifting through news even tougher, as we must live through the same noise that’s clouding our vision of our path through it. Yet these are the precise conditions of uncertainty that every dislocation of the past has marked its bottom in terms of equity prices, as we highlighted in our first piece in early March.

Any sizable market correction tends to be indiscriminate, torching everything along its path despite varying degrees of business model resilience. This is especially magnified in a world with increasingly quantities of algorithmic participants and passive strategies holding baskets of underlying issuers. These conditions caused the 34% downdraft across 23 trading sessions particularly difficult to sidestep. Rather than begrudgingly stare at the wreckage, it’s important to assess what current price levels reflect and what evidence can be utilized in sifting through the rubble. We covered some of this in our March 19th piece, taking a look both at implied earnings multiples as well as dividend yields.

As we uncover evidence of underlying business impacts since mid-March, we see varying degrees of severity, from complete demand erosion to demand spikes across various businesses. JPMorgan [JPM] shed some light on this in its earnings last week. Its credit and debit card network noted travel and entertainment spend in late March entirely disappeared, while restaurant spending plunged over 50%. Meanwhile, supermarket and wholesale club spend saw upwards of 75% increases. Although we don’t own JPM within the portfolio, it’s also an insightful exercise to note its balance sheet context: the $8 billion provision for loan losses booked in the quarter occurred at a 6x faster clip than the one JPM took across 3Q2006 - 1Q2008. Banks as a whole are much quicker to step up and recognize this dislocation in contrast to their multi-year denial campaign that led up to the financial crisis. Bank tier one equity capital as a whole is on much more solid footing in April 2020.

Meanwhile, online marketplaces, such as Shopify [SHOP] and Wayfair [W], noted demand accelerations at the end of March and into April. Wayfair specifically commented on a doubling of YoY growth—from 20% to 40%—at the end of March/early April, while Shopify noted seeing Black Friday level traffic since the end of March. Square [SQ] also provided evidence of its merchant customers quickly shifting to online fulfillment and curb-side delivery during its March 24th business update call. Zillow [Z] made the quick decision to halt home buying via its Zillow Offers segment, while walking investors through stress test scenarios of its balance sheet on its March 23rd update. With unique pre-demand insights across its 196 million monthly home shopping visitors, Zillow has since noted various metropolitan regions recovering in home shopping demand into April. Requests to contact its Premier Agents are also showing YoY growth as of April 15th.

All of this suggests a plausible path to navigating the current environment, portfolio construction wise. Efforts on returning life back to normal largely center around our ability to combat the virus at the molecular level via therapeutics and/or vaccinations. Thanks to the unparalleled tools of modern science, not only do we know the virus’s structure (unlike in 1918 when H1N1 initially was thought to be a bacteria), but we know its genome blueprint via RNA sequencing, and we know how its protein spikes trick host cells into replication. Insights on the nature of these mechanisms are exactly the types of challenges machine learning and big data are squarely designed to tackle. Hence, why we're seeing partnerships with tech titans on supercomputing capacity. Early signs of promise are being revealed by doctors utilizing therapeutics, and the script is steadily evolving towards being a matter of when, rather than if, we'll develop a solution.

In the meantime, increased awareness of social distancing, hygiene practices, and face mask utilization, while increasing availability of antibody testing and PCR testing, will aid in avoidance of overtaxing our healthcare system. All of this entails execution risk by the scientific and healthcare community, not to mention adherence by a global population of billions, in order to stem additional waves of incidence. Similar to how officials are describing reopening the economy in a dimmer-switch fashion, versus a binary on/off switch, daily accrual of progress towards recovery could strongly correlate with market pricing. Collective investor focus will soon shift to 2021 scenarios, where many of our Growth Equity positions will be well poised to capture various demand shifts.

Important Disclosures

Performance results and comparisons are made on a total-return basis, which include all income from dividends and interest, and realized and unrealized gains or losses. SWS Growth Equity returns are shown both gross and net of fees and are calculated by geometrically linking month-end market values of the strategy's inception cohort. Gross return excludes advisory fees paid to the firm. Net returns include the time-weighted deduction of the firm's maximum wrap fee (which includes both SWS's management fee and trading costs) and assume all cash flows occur at month-end.

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This portfolio of individual equity and pass-through securities and our forward-looking statements or projections are subject to risks including but not limited to portfolio concentration risk, company-specific risk, regulatory risk, financial market risk, global economic risk, credit risk, interest rate risk, foreign market risk that may involve currency, political, and social risk.

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The Russell 1000 Growth Index is a market cap-weighted index of common stocks incorporated within the US and its territories and may not necessarily be substantially similar to your portfolio. It is not possible to invest directly in an index.

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This commentary has been prepared by SWS Partners, LLC ("SWS"), a registered investment adviser in the state of Ohio. If you would like a copy of SWS's disclosure brochure, please visit www.adviserinfo.sec.gov.

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