SWS Growth Equity

Strategy Update as of September 30, 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
PMs	Michael Parker, CFA Kurt Grove, 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.

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Satisfying Absolute and Relative Outcomes

We view our quarterly updates as accountability milestones. The main goal is for the embedded analysis to act as the ultimate arbiter on whether our premise remains valid while assessing our efforts to deliver results. Despite what feels like a year's worth of market-impacting news squeezed into a single quarter—we take a stab at deciphering some of this later in our Market Perspective section—3Q2020 was accretive in both relative and absolute terms, and we remain optimistic on continuing our quest for sustainable alpha delivery. We also see strong odds that the output of these efforts could satisfy two important investor bases, the ever-discerning relative performance seekers and those more focused on absolute outcomes. The details behind this reveal that long-term capital is well served by focusing on the sources of disruptive innovation.

First, a side note on persistent uncertainty. Attempting to see through the haze is core to what we do, and it will always be so when investing in public equity. Assessing today's seemingly limitless slate of imperfect information, it's becoming clearer that the thesis we identified back in March—better outcomes require being over-indexed to the digital enablers—continues to be a critical thematic overlay in navigating the current environment. It also suggests that we don't require "all-clear" signals on the election, stimulus sizing/timing, or COVID therapeutics/ vaccines in order to deliver attractive return results. It does require careful diagnosis of the root causes behind the current massive demand shifts and deciphering what's sustainable versus transitory.

Investing amidst a backdrop of COVID exhaustion can make it easy to overlook how increasingly reliant shareholder value creation has become upon digitally-sourced innovation. We highlight evidence of this in Contributors & Detractors (page 4), but it provides a helpful reminder why it's imperative to make the identification of the source and directionality of disruptive innovation a core investment process tenet. This is also directly tied to why the vast majority of active managers fail: many investment processes rely upon predefined signals (market technicians) or strictly-defined parameters (fundamental investors) to signal investment attractiveness. Then, the hope is for these static screens to deliver opportunities meriting further analysis. The critical misstep here loses sight of the fact that innovative disruption is increasingly forming long

before its artifacts materialize in GAAP financials. When they eventually arrive, results have already moved from the windshield (prospective) to the rear-view (retrospective). Any effort to study their merits becomes an exercise of underwriting the past.

The notion of technologically-driven disruption and its expansive impacts are not new. Marc Andreessen outlined a key driver to this in his famous "Why Software is Eating the World" piece nearly a decade ago. Rereading it with the benefit of hindsight reminds us 1) win-rates are never flawless (e.g. Groupon and Living Social's attempt to join Google's ranks in marketing were short-lived) and 2) the speed of innovation's treadmill has only accelerated. There are countless anecdotes to support this, but consider a more objective approach to assessing technology-driven innovation's impact on the entire US economy: studying the average index constituent's duration in the S&P 500.

During 1958, the average company's stay within this index of "blue chip" US issuers was 61 years. By 1980, the average index membership dropped to 25 years, then to 18 years by 2011. We've taken past stabs at diagnosing this root cause from a slightly different angle, which revealed a steady infiltration of "growth" style companies into the S&P 500 over the past two decades. In a nutshell, digital disruption erodes competitive moats with increasing speed, causing blue-chip index participants to drop out faster. Thanks to machine learning's ability to draw better conclusions and cloud computing's nearly-endless scalability, the tools available to test, develop, and deploy strategies to stay ahead of customer demand have never been more powerful.

Some battlegrounds contain definable boundaries (e.g. electric vehicles' penetration of the global light vehicle market), while future ones will open up entirely new addressable opportunities. This past quarter provided crucial glimpses of the latter: Tesla's highly-anticipated battery day offered blueprints on cell design and materials enhancements that could usher in tera-watt hour capacity from renewable sources at the expense of combustible ones. Illumina's announced acquisition of liquid biopsy provider GRAIL, Inc. highlighted a new frontier in cancer screening, diagnosis, and treatment, largely enabled by a lower plot point along genome sequencing's cost curve. Carefully mapping the course of these developments will prove critical to our idea generation pipeline.

As we gain clarity on the uncertainties of today, only to be displaced by inevitable uncertainties of the future, universal truths will always have a tendency to get lost in the shuffle. We continue to believe that a prudent north star will be careful diagnosis of the cause of disruptive innovation. This will require portfolio construction to be tightly coupled with risk management, a practice key to avoiding massive performance give-backs during market draw-downs. We see these efforts contributing to a robust idea generation pipeline, which should allow us to continue on our quest for value creation in both relative and absolute terms.

Raison D'être: Alpha Delivery

Equity markets posted a positive 3rd quarter, building upon the strong rebound experienced in 2Q. The S&P 500 rallied in late August, joining the Russell 1000 Growth Index in eclipsing its pre-pandemic all-time high set in February, before a mild pullback to close out 3Q. Growth-style indices once again led the field in 3Q, building upon their relative YTD lead over value indices. SWS Growth Equity was able to capture positive alpha in 3Q, producing +14.26% total return gross of fees, relative to our growth index of 13.22%. The S&P 500 returned +8.93% over the same

period, underperforming the growth index due to its larger weight to financials and energy components, both laggards during the quarter. The S&P's lower relative weighting to technology, an out-performing sector, also was to blame.

Chart 1: SWS Growth Equity Performances as of 9/30/2020

	3Q2020	1-Year	2-Year (Annualized)	Since Inception (Annualized)	Since Inception (Cumulative)
Growth Equity (net max fee)	13.90%	32.85%	21.48%	25.42%	72.87%
Growth Equity (gross)	14.26%	34.11%	23.02%	27.01%	78.19%
Russell 1000 Growth	13.22%	24.33%	19.43%	22.44%	63.10%
S&P 500 (reference)	8.93%	5.57%	9.57%	12.49%	32.89%

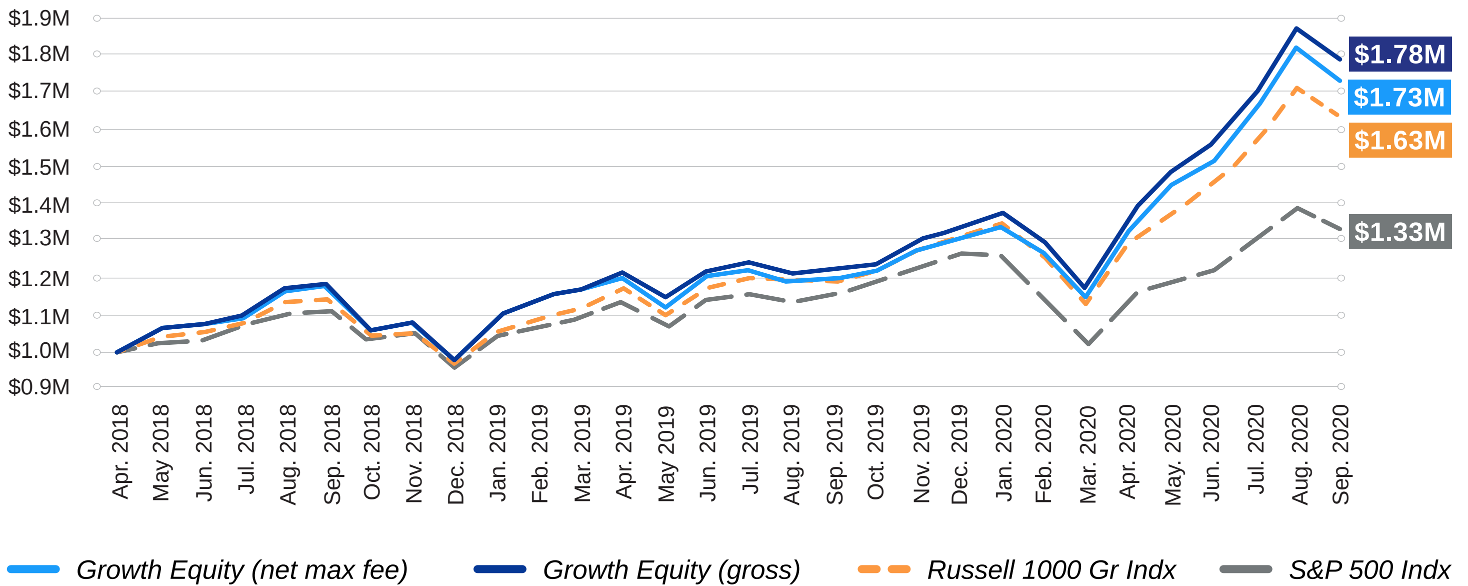
Please see performance disclosures on page 12. Growth Equity inception 5/1/2018.

Chart 2: Equity Indices 3Q2020 Total Returns

Russell 1000 Growth:	13.22%
S&P 500:	8.93%
Russell 1000 Value:	5.59%
Russell Midcap:	7.46%
Russell 2000:	4.93%
NASDAQ Composite Index:	11.24%

Source: FactSet. Data represent total return (dividends reinvested into respective index) for the period 6/30/2020-9/30/2020.

Chart 3: 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.

Contributors & Detractors

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

Top Contributor

Zillow Group, Inc [Z] +76.3%, Square, Inc [SQ] +54.9%, Wayfair, Inc. [W] +47.3%

Zillow, Square, and Wayfair continued their persistent presence on our list of contributors & detractors. Rather than rehashing old points, we have linked above to our recent writings and are updating incremental information gleaned over the last quarter. These three issuers are examples of companies with the perception of highly uncertain outcomes, where the differences between bull and bear theses are wildly divergent. This tends to result in a much more volatile valuation process relative to other portfolio constituents. The 3rd quarter delivered more favorable arguments for the bull thesis behind all three companies, and they all centered around benefits from digital disruption and COVID-19 related effects. Square and Wayfair, top performers last quarter, both prospered

from the lockdowns, seeing respective revenue growth of +64% and +83% in 2Q. Throughout the third quarter, both highlighted continued strength even as lockdowns abated, underscoring the long-term trends in digital wallets and ecommerce. Zillow has also seen business model endorsements from the lockdowns' favorable impact on home purchase intentions in the suburbs. As the leader in digital aggregation of consumer housing eyeballs, the company has also revamped its home-buying efforts via its Zillow Offers iBuy offering with value extraction crosshairs squarely on the traditional 6% sales commission.

illumina®

Top Detractor

Illumina, Inc [ILMN]: -14.6%

It was a tale of two halves for the ILMN's third quarter, appreciating 9% through August 5th, before falling 33% between August 6th and September 22nd on the heels of a slightly disappointing earnings report and an announced acquisition of Grail for $8B. The majority of the underperformance was explained by the large drop after the rumor and official deal announcement, typically a sign of poor reception by the market. Concerns were wide-ranging from the deal being too expensive, a change in strategy by ILMN which previously had spun out Grail, to the resulting combined company now competing directly with its customers. We evaluated all of these concerns on their respective merits:

The deal being too expensive: Grail is a leading player in the liquid biopsy space, focusing its attention on early detection asymptomatic cancer screening through a blood draw, a $50B addressable market. The company has recently exhibited strong early trial results, along with an ability to screen 50 different types of cancer. This has the potential to revolutionize treatment trajectories with newly introduced, minimally invasive detection capabilities.

A change in strategy: While the company did spin out Grail only to reacquire it, ILMN still owned 15% of Grail post-spin. We think ILMN, with its leading position in sequencing, has unique insights into what technologies are progressing faster than others and determined Grail as an early winner. This illustrates a common thread behind "Innovator's Dilemma/Solution"; Grail would have been unlikely to achieve the success it has seen without being spun out from core ILMN.

Competing with its customers: We recently attended a virtual liquid biopsy conference, where ILMN's customers/competitors spoke about the large addressable market of liquid biopsies and explicitly stated not being overly concerned with the acquisition by ILMN. We think the questions have been sufficiently answered and believe the market is digesting the acquisition, as highlighted by the stock's 18% recovery since the September 22nd bottom.

AbbVie, Inc. [ABBV]: -9.6%

All 3 of our detractors this quarter originated from the healthcare sector, which lagged as a sector with a +3.6% return versus the Russell 1000 Growth's +13.2% results. The only pockets of strength in healthcare came from select medical equipment names and direct COVID-19 beneficiaries. Recent investor focus for AbbVie has been on the now-completed acquisition of Allergan and the upcoming patent expiration of leading revenue contributor Humira. Bears have been pointing at Humira, comprising 46% of total revenue, as a source of major concern. Draconian projections call for future Humira revenue to fall to zero in the US after 2022. While we acknowledge and appreciate this risk, we see upside well outpacing downside from current levels as the company trades 7x forward-earnings with reserved optimism around Humira's future. Evaluating patent expirations in Europe shows an approximate 44% decrease in revenue over 18 months with commentary from management indicating a stabilization as it lapped biosimilar competition, outperforming internal expectations. Combining a potential less negative development for Humira and AbbVie's growth assets in immunology and oncology, with drugs SKYRIZI, RINVOQ, and IMBRUVICA outperforming ABBV's internal expectations, we think pessimism is too high, which warrants position maintenance.

Vertex Pharmaceuticals Inc. [VRTX]: -6.3%

Continuing with the theme of healthcare underperformance, Vertex, despite having strong 3Q results, found itself on the list of detractors for the first time since Growth Equity's inception. Putting the underperformance in some context, VRTX has outperformed the Russell 1000 Growth health care index +78.5% to +30.4% since inception and +22.8% vs +7.9% year-to-date through September 30th. While VRTX experienced mild underperformance this quarter, the company posted several positive developments related to their treatments TRIKAFTA and KAFTRIO for cystic fibrosis, receiving positive rulings intra-quarter related to usage and reimbursement for their treatments in the US and Europe. With VRTX establishing a strong position in the treatment of cystic fibrosis worldwide we expect more attention will come to revenue cadence around uptake rates for TRIKAFTA/ KAFTRIO. As investors, we will closely follow the approval processes for additional geographies and younger patients of cystic fibrosis and subsequent incremental revenue generation. We also turn our focus to future promising opportunities related to Vertex's partnership with CRISPR's gene-editing program, fighting beta-thalassemia and sickle cell disease.

Portfolio Changes

As we enter month eight post the initial lockdown of the pandemic, we saw an opportunity to slightly reposition Growth Equity towards companies that will better benefit from a full lifting of lockdown restrictions and reposition our bets towards equities where prices have yet to reflect the underlying opportunity. During the quarter we added SFIX to the portfolio, made incremental adds to UBER, TWLO, VC, COR, and AMBA, and exited previous Growth Equity positions HD, HON, and CME. When evaluating the common theme behind the incremental additions, we find one subset of companies that have seen their competitive positioning strengthened from the pandemic while simultaneously having some of their core customers experience pandemic-related set-backs. For example TWLO, which supports the struggling ride-sharing, hospitality, and airline industries, and UBER, the leader in the global ride-sharing, were both well-positioned to capture massive demand shifts but were not entirely immune to adverse exposure. We also see other companies that have had positive incremental design wins be overshadowed by the global macro slowdown. For example, the global automotive production slow-down has obfuscated positive traction within digital clusters for Visteon, while key computer vision design wins at leading OEM's by Ambarella have yet to be fully reflected in its share price.

Portfolio Addition

Stitch Fix, Inc. [SFIX] - We see Stitch Fix as a company with an underappreciated strengthening competitive position amidst the pandemic. With its core customer transitioning lifestyles to work-from-home and limited social interactions, the company experienced dampened growth, in turn causing a dislocation in market expectations. We saw this backdrop as an opportune time to enter a position. Stitch Fix, an online-only retailer, describes itself as a data-driven personalization engine for retail, designed to give the shopper what they desire and make the process of browsing enjoyable in the online world versus the endless "page-clicking" of traditional ecommerce. Many may know of Stitch Fix as a boxed, subscription-only monthly retail delivery service, but the company's recent expansion into direct-buy significantly expands the addressable market while lowering customer acquisition costs. There are many skeptics of this business model, and more ammunition was added to this bear thesis as SFIX delivered -9% and 2% revenue growth in the May/August quarters respectively. This notably lagged ecommerce growth posted by others, such as when Wayfair and Amazon both posted >40% growth. We think this comparison is unwarranted as the apparel industry has experienced severe contraction: US retail sales data indicates apparel sales fell 88% from its peak-2019 levels this past April and is still down -20% through August. In comparison, furniture and general-purpose spending did not fall nearly as much and has returned to positive growth in June versus year-ago levels. While SFIX has not disclosed explicit details around apparel use-case breakdown, the company has indicated a significant component of revenue comes from office attire, along with "event" clothing for weddings/vacations/etc. We see these spending outlets returning as lockdown restrictions fully lift. Therefore we take a more optimistic view of SFIX results post-pandemic, which outgrew the apparel industry ~50% over the two previous quarters. Longer-term, we expect more attention to focus on SFIX's dedication to data science. Perusing Stitch Fix technical blogs and Github pages highlight an extreme focus on data-driven decision making that other retailers are unlikely to match, and we expect SFIX to continue to garner more share as apparel spend increasingly moves online.

Market Perspective: Recovery and Digital Disruption

Investors will always need to assess how the evolution of the political landscape impacts the value of their capital. Sometimes this landscape moves at Pangea-like speeds, and at other times it arrives in the form of an earthquake that alters the face of mountains. An antitrust subcommittee in the House delivered its staff report earlier this month that leaves some investors questioning which end of that spectrum this specific source of political risk resides. Although we view it as an extremely important development to monitor closely, we see night/day differences between each side's strength of argument.

On October 6th, the House Subcommittee on Antitrust, Commercial and Administrative Law of the Committee of the Judiciary filed its findings from a sixteen-month investigation of four companies, all Growth Equity constituents, Apple, Amazon, Google, and Facebook. The impetus of the investigation was to examine their dominance and business practices in relation to current antitrust laws, competitive policies, and current enforcement levels in order to assess whether they are adequate to address market power and anticompetitive conduct.

After pouring over the 449-page report, the subcommittee's concerns are wide-ranging but center around market control of voice assistants, pre-installation of web browsers, usage of open-source software, relative power of app stores, treatment of software developers, and acquisition histories. Recommendations coming out of the report include 1) address anticompetitive conduct in digital markets, 2) strengthen merger and monopolization enforcement, and 3) improve the administration of antitrust laws through other reforms.

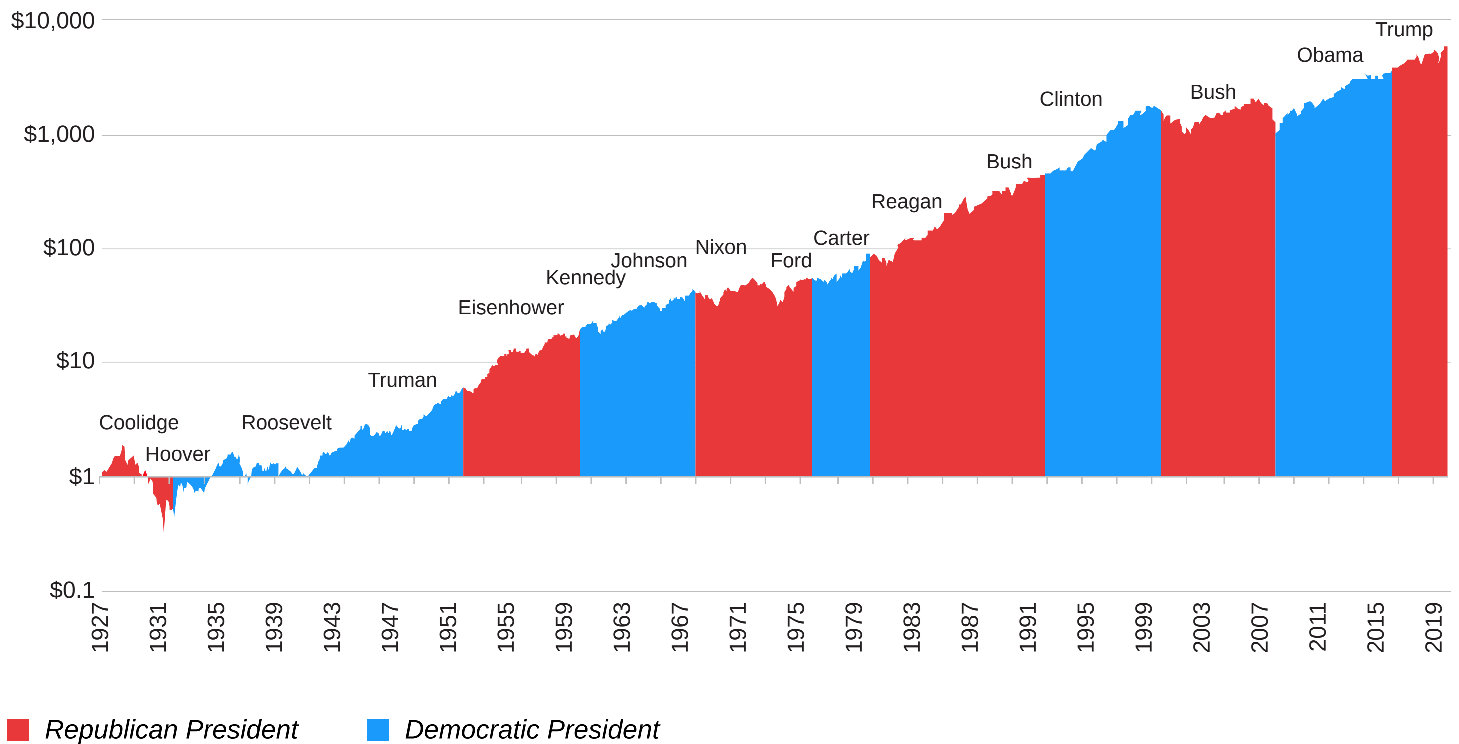
There are many moving parts for these findings to make their way into future legislation, and we will continue to monitor these developments. However, we find the live Q&A that we attended back in January 2020 with FTC chair Joseph Simmons to be helpful in providing context for the US government's ultimate role in anti-competitive situations. Paraphrasing chairman Simmons' commentary (the following is not verbatim), "We want to subject our companies to competition so they get better, foreign or domestic...We don't go after companies because they're big and successful nor should we penalize them for success...We also don't break up companies just because they are big." While we never take the threat of regulation lightly, we believe our current exposure to these tech mega-caps are appropriately balanced relative to the downside risk of escalating regulator tensions. As of right now, the government appears to be more focused on report page count than strength of argument around truly anti-competitive dynamics. That said, this is a very fluid topic that's likely to be "newsy" over the foreseeable future.

The only thing certain about political uncertainty: it comes in many forms and can be tough to predict. The subcommittee's efforts are one aspect, while November moves us closer to solidifying compositions of both executive and legislative branches. Given that this particular exercise recurs on four- (presidential) and two-year (midterm) cycles, the market is no stranger to digesting, and seeing through, this newsflow. The market's embedded probability-weighing mechanism also will not wake up on November 4th and flip from 0% to 100% should the underdog win; each day that probabilities shift in one way or the other, all prices adjust in anticipation of the changing outcomes.

It's easy to fall down a rabbit hole when attempting to assess which political outcomes are more market-friendly. Taking a step back to avoid forest-for-the-trees syndrome, we see strong odds that executive leadership of US

businesses will continue to deploy their fungible capital towards attractive returning pursuits. The economy in turn will grind forward regardless of party composition in Washington. Chart 4 below at first glance is elementary but acts as an elegant reminder of how this dynamic has unfolded—and likely will unfold—across decades of shifting political winds:

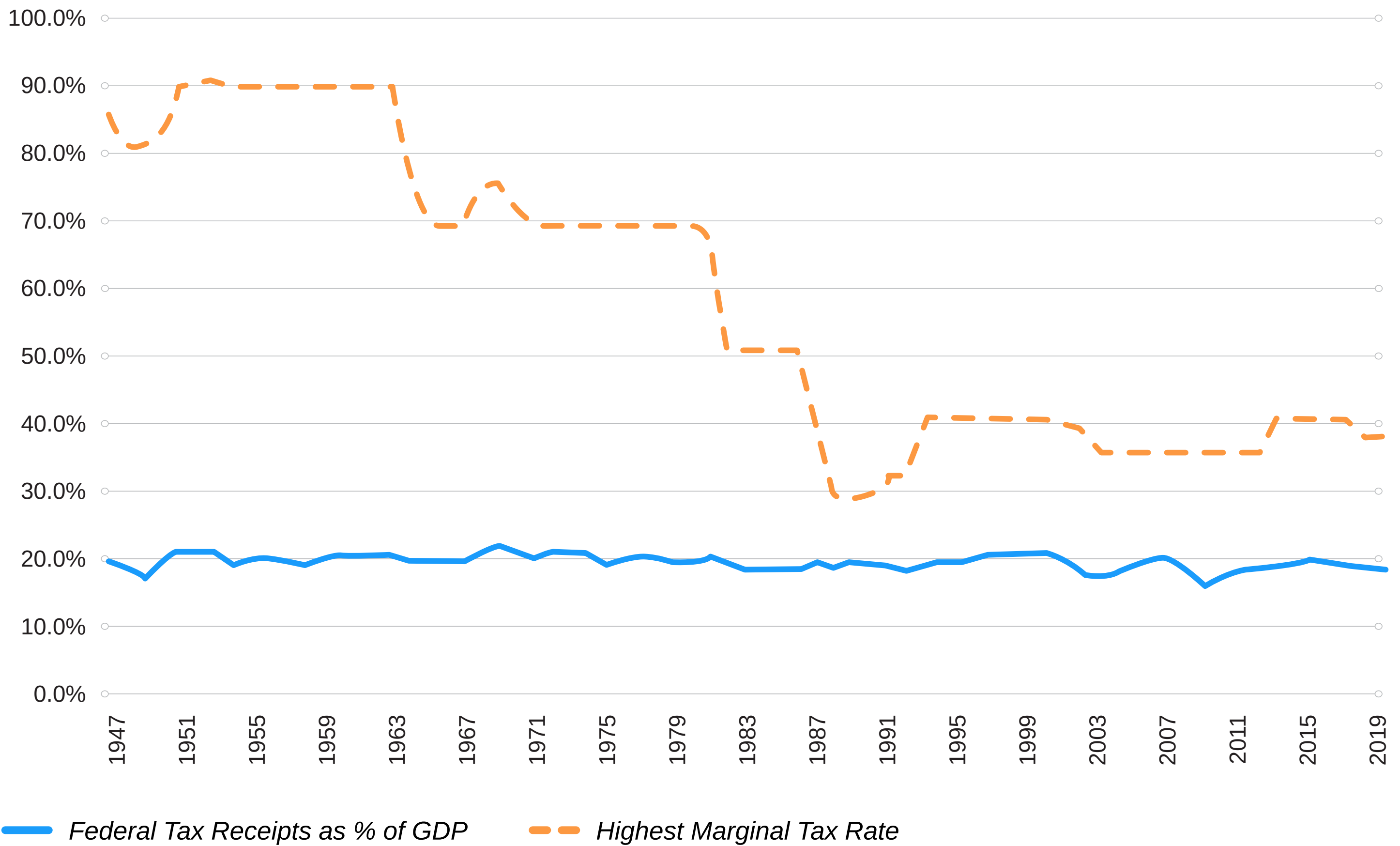
Chart 4: Growth of $1 Since Coolidge



Republican President *Democratic President*

Above represents growth of $1 invested in the S&P 500 Index since 1928 including dividend reinvestment. Please see disclosures on page 12.
Source: S&P Global, FactSet

Chart 5: Federal Tax Receipts in Relative Context



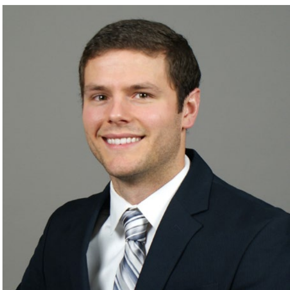
Source: Tax Policy Center, Urban Institute and Brookings Institution; US Bureau of Economic Analysis; FactSet.

The bar for public equity investors to ingest information is always being raised. Setting all current macro factors on the scale, we see enough visibility for economic value creation to continue, which should bode well for equity market appreciation. Retaining consummate adaptability at our core will continue to prove essential, along with the need to identify and leverage all aspects of our increasingly digital futures. This will likely translate into more front-end work behind idea generation (e.g. reading through 400 page Congressional subcommittee reports, ramping up on a chemistry curriculum to understand new battery structures, studying trade-offs of specificity vs. sensitivity in liquid biopsy, etc.), but these are the exact conditions that excite us on relative value creation opportunities given. This backdrop is precisely one in which SWS Growth Equity's investment process is built to thrive.

About the Authors

Portfolio Manager

Michael Parker, CFA, is the CIO of SWS and lead 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 eighteen 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.



Portfolio Manager

Kurt Grove, CFA, is a portfolio manager for the SWS Growth Equity strategy. Before joining SWS in 2020, Kurt was an analyst on the internal active long-only US equity portfolios at Ohio Public Employees Retirement System (OPERS). He leverages over 7 years of experience on the buy-side and in risk management to bring an institutional research and portfolio management framework to SWS Partners. Prior to OPERS, Kurt was responsible for Quantitative Risk Management at Key Bank. He received his Bachelor of Science in business administration, finance concentration, from the Fisher College of Business at The Ohio State University and is a CFA® charterholder.

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Important Disclosures

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