SWS Growth Equity

Strategy Update as of October 20, 2021

Firm Overview

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

Key Information

Inception	May 1, 2018
Benchmark	Russell 1000 Growth Index
Portfolio Managers	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 profitable market share.

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The third quarter of 2021 was a detractor to SWS Growth Equity's performance, declining 0.34% on a gross basis relative to a 1.16% total return in the Russell 1000 Growth Index. On a year-to-date basis, our 14.61% gross return remained ahead of our bogey's 14.30%.

We break down the puts and takes in contributors/detractors, but our read of the current fundamental signals continues to support that 2021 will be a grind-out period for active return generation. This in large part is due to a global macro dislocation that caused the most dramatic acceleration of digital transformations across all industries. The market is still undergoing a massive sortation of flash-in-the-pans from sustainable share-gainers as we edge closer to a post-pandemic environment. As active equity managers tasked with relative value creation, we remain optimistic on how our investment process is calibrated to generate attractive risk-adjusted outcomes in this backdrop.

An inescapable truth of public equity: the same mechanism that marks its value is subject to dislocations caused by other participants trafficking in the underlying. This occurs regardless of the changing participant composition and their motives, and 2021 has seen its fair share of flow-related disruptions. Pinpointing their exact source can prove difficult, thanks to the anonymity of dark-pool and algorithmic trading. Timing when pricing dislocations occur also can be futile in the era of frictionless, commission-free execution via smartphone app. However, we have some artifacts to assist in sizing their presence and revealing the potential rationale behind their trading activity.

Nine of the 10 most active call-option days ever in history took place in 2021. The notional value traded in single-stock equity options also surpassed the actual value traded in the underlying equity this year, for the first time ever on record. Certain issuers, like AAPL and TSLA, even saw their options' notional value traded exceed 1.7x and 4.0x that of their underlying equity, respectively. These conditions make option expiration dates ripe for powder-keg formation, in turn creating increased equity price volatility. Equities in a sense become derivatives of their own derivative, somewhat a case of the tail wagging the dog.

Audio Version

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Another flow-driven impact relates to geopolitical factors, the most salient this year being from China. When the Evergrande shoe-drop followed a series of earlier red flags signaling that Beijing may be retracing its steps to wade selectively into capitalism, mega-cap tech titans like Apple, Microsoft, and Alphabet take on the role of relative tech-sector safe havens when Alibaba, Tencent, Didi, and others find themselves in political crosshairs. This flight-to-safety via US-domiciled mega-caps undoubtedly created a market cap headwind for our lower relative weighted average market cap, specifically a 2,200 bps one over the Mar-Aug 2021 timeframe. We've covered the fundamental justifications to skewing down the market cap spectrum at this stage of economic recovery, but we see mega-caps in the $trillion club as showing signs of top-heaviness. As such, we see merit in remaining under-weight market cap over the medium-term environment.

Other markets act as popular on-/off-ramps to public equity, invariably causing disruptions when speculators rush in or head for the exits. Cryptocurrency is one with an increasingly formidable presence, with its current aggregate size topping $2.5 trillion, a mere 10-fold increase from just three years ago. This asset class's "market cap" now surpasses that of Apple, Microsoft, and Amazon.

SPACs are another. Although, once successfully completing their transformation from private to public, their shares fall squarely within the boundaries of the publicly traded market. Their pricing outcomes also bear heavier weight on aggregate results, as the 205 SPAC conversions completed since 2016 now account for over $363 billion in aggregate market cap.

It's also critical to consider the magnitude and composition of pandemic-related stimulus given their ripple effects across the capital markets. Instead of directing $trillions towards shoring up global banking capital reserves during the financial crisis, last year's coordinated stimulus (also in the $trillions) landed directly in consumer checking accounts, largely via ACH direct deposit. It may seem like a subtle difference in terms of where on the balance sheet each shows up—equity (via preferreds in 2008/2009) or liabilities (via deposits in 2020/2021)—but the differences in their immediacy of consumption deployment are night-and-day. During the financial crisis, it took years to coax banks into extending credit to businesses and consumers. During the pandemic, we handed cash directly to both.

These stimulant floodgates also opened onto massive, multi-lane spending highways, where the convenience of our smartphone allowed for instant deployment towards same/next-day online shopping and/or the ability to speculate in any flavor of crypto or derivative security.. It turns out these are also the perfect conditions for elevated inflation and supply chain bottleneck formation. Some silver linings here, we can see the pig being digested through the python: the rise and subsequent fall in savings rate, a sunset in extended unemployment benefits, and the expiration on eviction moratoriums. As such, our stance is somewhat aligned with Fed and Treasury leadership on inflation being more transient than systemic in nature.

We also know that technology is inherently deflationary. It allows more units of output to be squeezed out of the same hour of labor input. Evidence of this is far easier to observe on the manufacturing side of our economy, as robots populate every major factory. Less obvious are the efforts impacting the services side, our largest economic contributor to the US economy. The ROI potential here is arguably even more massive. They tend to revolve around the ability to leverage insights from an ever-increasing universe of data. Two of our top 3Q contributors highlight important arms dealers on this front.

Even though calendar 2020 pulled forward many digital transformation projects across every facet of the economy, we continue to see massive opportunities for business models to proliferate atop platforms created by the cloud titans. It's essentially a live experiment of what can happen when every business can treat its compute capacity as a utility. It ushers in a paradigm shift of innovation. Uncovering when and where this happens requires deeper analysis. It also brings with it the need to forecast cash flow generation further into the future, and the fortitude to stomach pricing volatility from the changing composition of participants along the way.

Given our investment process was built for these exact conditions, we remain incredibly optimistic on our quest for attractive risk-adjusted outcomes for our shareholders. Thank you for your continued confidence in our efforts as stewards of your capital.

Raison D'être: Alpha Delivery

The second quarter saw mixed equity market results in the US, with the S&P 500 eking out a +0.6% gain. Large-caps via the Russell 1000 bested small-cap equities via the Russell 2000 at +0.2% versus -4.4%, and growth outperformed value with the Russell 1000 Growth returning +1.2% and Russell 1000 Value -0.8%. Strength in the quarter was again led by mega-cap tech, more narrowly constrained relative to the second quarter, with Google, Apple, and Microsoft all outpacing the indices for the quarter. *SWS Growth Equity* returned -0.3% gross of fees for the quarter, relative to the Russell 1000 Growth at +1.2% and the S&P 500 at +0.6%.

Chart 1: SWS Growth Equity Performance as of 9/30/2021

	3Q2021	YTD	3-Year (Annualized)	Since Inception (Annualized)	Since Inception (Cumulative)
SWS Growth Equity (net max fee)	-0.66%	13.54%	25.42%	27.78%	131.09%
SWS Growth Equity (gross)	-0.34%	14.61%	27.01%	29.40%	141.21%
Russell 1000 Growth	1.16%	14.30%	22.00%	23.85%	107.66%
Russell 1000 Value	-0.78%	17.01%	10.34%	11.09%	43.22%
S&P 500 (reference)	0.58%	15.92%	15.99%	17.36%	72.77%

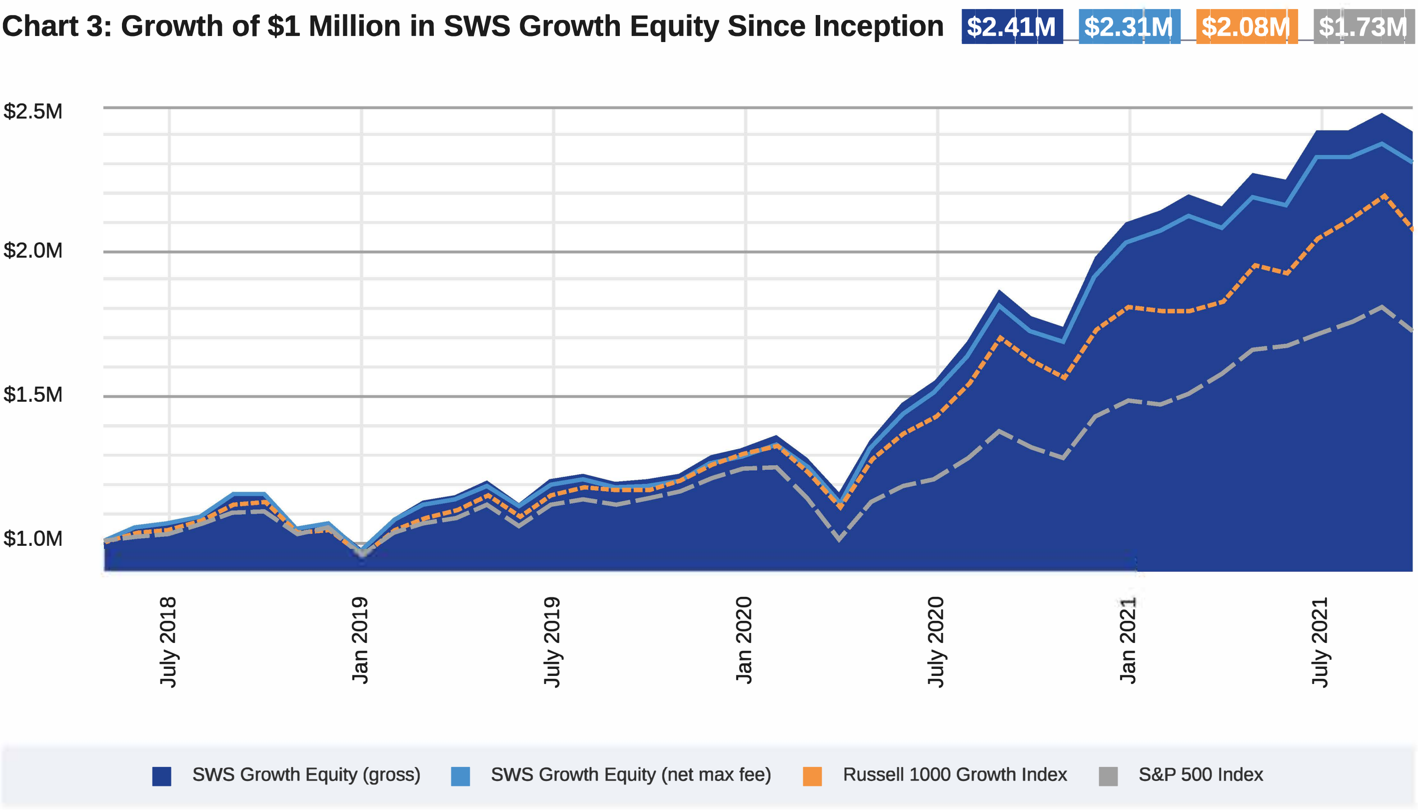
Please see performance disclosures on page 12. SWS Growth Equity *inception 5/1/2018.*

Chart 2: Equity Indices' 3Q2021 Total Returns

Russel 1000 Growth	1.16%
S&P 500	0.58%
Russell 1000 Value	-0.78%
Russell Midcap	-0.93%
Russell 2000	-4.36%
NASDAQ Composite Index	-0.23%

Source: FactSet. Data represent total return (dividends reinvested into respective index) for the period 6/30/2021-9/30/2021.

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

Atlassian Corp., [TEAM]: +52.4%

Last appearing on our list of contributors in 1Q2020, TEAM's fundamental thesis remains intact, and the general theme of software's total addressable market ("TAM") continuing to surprise the equity markets to the upside remains. Atlassian significantly outperformed this quarter, appreciating +52.4% relative to the software sector at +3.8%. TEAM uniquely benefits from the adoption of software solutions by providing leading tools for collaborative, efficient software development across its three core product offerings of agile development, IT service management, and work management. This equates to an addressable market of 27 million global software developers, 100 million technical team members, and 1.1 billion knowledge workers. Currently, Atlassian serves just 15 million monthly average users ("MAU") on its cloud products, leaving a long runway for growth as the importance of software to all workers increases every year. Translating this to the financial statement, 63% of TEAM's revenue is now subscription-based, with the spigot for new licensed server offerings closing as of 3Q2021. With a strong report this past quarter, we now expect a >40% annual growth rate over the next three years in subscription revenue, equating to a total top-line of >$4 billion in 2024. This medium-term guidance of >40% growth is 10% above our written expectations from 1Q2020 as TEAM benefits from enabling software to continue eating the world.

Top Contributor

Ambarella™

Ambarella, Inc. [AMBA]: +46.1%

Ambarella delivered a strong performance this quarter, appreciating +46.1%, well above its semiconductor peers at +1.8% over the same period. AMBA is a position we've held in *Growth Equity* since our May 2018 inception and a company we've tracked closely since its 2012 IPO. With an initial flagship design win in the early 2000's Flip Video camera, subsequent rise and fall with GoPro design-in, and a painful transition away from consumer end markets, today AMBA sees the majority of its revenue derived from the automotive, security camera, and internet of things ("IoT") markets. We have long held the belief that under the leadership of Fermi Wang (CEO), Les Kohn (CTO), and Alberto Broggi (founder of Vislab), a focused computer vision ("CV") solution, coupled with best-in-class video compression and image processing, a low power envelope, and an open architecture would be perfectly aligned to address the forward-facing advanced driver assistance systems ("ADAS") market. This is in stark contrast to strongly-held views that more sensors (LiDAR, radar, ultrasonic, etc.) are always better than fewer. Some recent industry milestones have shifted the pendulum further towards favoring a vision-only future in autonomous driving, while entirely new super-computers are being designed to mimic the human visual cortex.

Specific to this quarter, updates were solid for Ambarella, with positive commentary from almost every business segment. In the IoT space, AMBA announced wins with Amazon Ring and Vivint. The company also highlighted wins in the professional security camera market via Honeywell and Bosch. Previous headwinds related to China exposure, detailed in our 2Q2020 list of detractors, turned into tailwinds as AMBA has picked up share at Hikivison and Dawha following US trade restrictions that have limited Ambarella's biggest competitor, HiSilicon. The biggest news came in the automotive segment, where driver monitoring and fleet management system wins were announced at KeepTruckin, Yandex, and Solera.

Listening to announcements and management commentary, it's becoming increasingly apparent that the long-awaited company transition is taking hold at Ambarella. Mounting evidence to this includes CV wins at AWS for robotics/edge device applications, major Level 2+ ADAS wins at Motional and Arrival, and a $600 million automotive pipeline update in October 2020. We expect further positive updates at CES in January 2022. Additionally, sometime in 2022, we are looking for the first major North American/European OEM to announce the adoption of an AMBA chip. It would not be surprising to see a forward-thinking OEM, unencumbered by legacy design decisions, be able to utilize clean-sheet-of-paper thinking around vision-based autonomy. Rivian's efforts to ramp engineering talent in computer vision, combined with its production timeline, make it a particularly interesting prospect.

Up until this most recent quarter, the equity market has been highly focused on other new SPAC issuances or EV startups, largely ignoring fundamental progress at Ambarella. This oversight allowed us multiple opportunities to add to our AMBA position in July and September of 2020 and again in July of 2021, resulting in it becoming our largest active position as of this writing.

Top Contributor

snowflake®

Snowflake, Inc. [SNOW]: +25.1%

Snowflake, last detailed in our 1Q2021 quarterly, outperformed this quarter with a +25.1% return versus its software peers at +3.8%. After being priced out of the first day of trading and its subsequent run-up to $429/sh in December, we were happy to see share weakness translating into a buying opportunity. As such, we picked up shares in the ~$215-$230 range from March to May this year.

We view Snowflake as a platform of the future, the first of its kind developed specifically for the cloud. The opportunity for long-term growth will come from three distinct opportunities. First are replacements of first-generation cloud products, namely Redshift, and fast adopters of cloud workloads utilizing the full breadth of Snowflake's offering. Such paths are similar to the one that Capital One took with SNOW, a customer that spends ~$30 million annually with Snowflake as of the time of its IPO.

Second, Snowflake is aimed squarely at disrupting legacy Hadoop, Netezza, SQL, and Teradata data workloads, where the question is "when" not "if" these workloads will move over to the cloud. The issue is timing, as these are extremely difficult to migrate. Snowflake's CFO, Mike Scarpelli, gave an example of a large European retailer that signed up two years ago but wouldn't retire its Teradata workload until next fiscal year. Regardless, the customer's annual spend with Snowflake went from $1 million to $8 million, with expectations to grow to $20 million next year.

Third is the ability to monetize and act as a data broker for consumers and producers of data. One early example of this is Ibotta's roll-out of "try before you buy dataset" on Snowflake, giving an advertiser access to a subset of data to test the efficacy of the real-time dataset.

All these tailwinds sum to a highly attractive, long-term growth trajectory for Snowflake. At the latest annual investor day, long-term projections were for ~44% CAGR, equating to >$10 billion in product revenue by 2029, based on current Snowflake capabilities. Snowflake's product iteration has been rapid, most recently introducing Snowpark, expanding the addressable market to app developers, data engineers, and data scientists. Additionally, we expect FedRamp coverage in 2023, a potential 10-15% revenue opportunity. Both examples highlight the conservativeness of projections, and we would not be surprised to see Snowflake hit $10 billion in product revenue well before 2029.

Top Detractor

PureCycle Technologies, Inc. [PCT]: -43.8%

After appearing on our *list of top contributors* last quarter and heavily detailed in our *new position* section, we highlighted an expectation of heightened volatility in PCT, a pre-revenue SPAC. Volatility works in both directions, and PCT underperformed the basic materials sector this quarter, returning -43.8% versus -4.0% for the cohort. In the short time since our initiation in May, we have been pleased with the announcements and progress PCT has made. PureCycle announced a number of key updates: 1) Location of a second cluster location in Augusta, GA, 2) Filed an NOL (no objection letter) with the FDA for the usage of recycled polypropylene in food packaging, 3) Two partnerships in South Korea and Japan, 4) The opening of a plastic waste prep facility in Florida to aid in the procurement of no. 5 plastic, and 5) incorporating a new pass-through pricing model for guaranteed margin profile.

While we still label PCT as a “speculative” type of investment as investors await the 4Q2022 go-live event with its factory in Ironton, OH, significant tangible progress has been made. The expansions domestically and internationally highlight the scale at which PCT intends to operate. A filing of an NOL gives credence to the technological process of recycling polypropylene via a solvent-based approach. The new pricing model and new waste prep facility bring about stability to the most uncertain parts of the model, volatile commodity pricing and feedstock procurement. These incremental updates and the continued monthly Leidos engineering reports gave us increased confidence in PureCycle’s plan to ultimately build 50+ plants, recycling a total of 6.5 billion pounds per year. As such, we took advantage of the pullback in the underlying equity to add to our position in August.

Top Detractor

Stitch Fix, Inc. [SFIX]: -33.7%

Stitch Fix finds itself on our list of detractors once again, after last making an appearance in 1Q2021, preceded by being *Growth Equity’s* top performer in 4Q2020. SFIX fell -33.7% this quarter relative to its industry peers appreciating +1.6%. It’s been a very volatile year for the equity price of Stitch Fix, requiring investors to balance its long-term prospects of becoming the personalized digital department store of the future with a five-month period that saw its equity price appreciate 475% subsequent to our initiation.

As we highlighted in our intro section, it is a ripe environment for active management now that passively-managed equities surpass active, that “free” trading has ushered in the rise of retail participation, and that notional values traded of equity derivative products surpass that of individual stocks. The implication for long-only equity investors: the need for market awareness akin to what’s more commonly found among hedge funds. Factor exposure analysis--which consider positioning, industry, size, and short interest, among others--is a critical part of the investment process alongside bottom-up fundamental analysis. It also requires a great deal of self-introspection on evaluating equity price moves, both to the downside and upside. Specifically for SFIX, we saw a performance spike in late January in tandem with other high-short interest securities, like Gamestop and AMC Entertainment. This allowed us to book some gains by selling a portion of our position at $82 and $105 in January, as we identified the run-up being market mechanics-related rather than fundamental.

Subsequent to this run-up and the pull-back that ensued, it’s been a tough couple of quarters for SFIX’s stock. We view this mispricing in context to the strengthening of our fundamental views to signal the opportunity to purchase more shares than we sold, with adds to the portfolio in March at $57, in May at $41, and most recently in October at $37.

At this point, we think sentiment and market forces now have swung too far, with the equity market overemphasizing negative headlines while ignoring positive developments. The CEO transition from founder Katrina Lake to the former head of digital strategy at Bain, Elizabeth Spaulding, brings about a more focused organization and allows for faster product iteration. We expect the “encouraged resigning” of stylists to be more a consequence of mix-shift towards the direct buy offering, while algorithmically-informed styling displaces what previously was more manual intensity for the human stylist. This should be an opex savings, allowing for redeployment towards increased marketing spend, further product iteration with “Freestyle," entry into new retail product categories, and expansion into new geographies.

Top Detractor

Zillow

Zillow Group, Inc. [Z]: -27.9%

Zillow finds itself on our list of detractors for the second quarter in a row, falling -27.9% relative to its internet software peers at +3.8%. We walked through Zillow’s weakness last quarter and think this quarter was a continuation of previous themes, surrounding concerns on the sustainability of the United States housing cycle and fear of peak margins in both the *Offers* and *IMT* business units.

We think it is a timely opportunity to look at Zillow through the TAM and optionality around the *Offers* business. Original long-term goals for the *Offers* business were purchasing 5k homes per month at a 4-5% return before interest and an average home turnover period of ~3 months, all solving for an annual ROIC of 16-20%. Additional revenue opportunities relate to loan originations, title services, and monetizing highly qualified leads for its army of premier agents of customers declining a Zillow offer on their home. The 5k purchased homes per month, i.e. 60k per year, equates to just

~1% of the 5.6 million existing US homes sales annually. Our belief is that iBuying will be much higher than 1% of the total market, as younger generations continue to enter the housing market and demand a more digital, Amazon-like home-buying experience. For example, 2Q2021 iBuyers have already hit 1% market share nationally. In Phoenix, Charlotte, and Atlanta, three initial test grounds for iBuying, recent data show 5% of the market is controlled by iBuyers.

Zillow, having a captive 229 million website visitors and now incorporating the Zestimate for actual cash offers, sits in pole position to unlock this market and to disrupt the traditional 6% commission enjoyed by realtors. This archaic commission model, not intended for the more transparent and easier to access digital age, is inhibiting housing turnover due to explicit costs. We would not be surprised to see housing turnover increase and average homeownership duration decrease as friction is removed from the home buying process. We ultimately view this pullback as an opportunity and recently purchased additional shares of Zillow in early October.

Portfolio Changes

As we have previously mentioned in 3Q and 4Q of 2020, we had been actively increasing our exposure to smaller market cap equities in lieu of large-cap pandemic beneficiaries. We still like this portfolio posturing, despite a headwind in this most recent quarter. We continue to carry a slightly higher turnover than projected, closer to 50%, as we continue to see opportunities to refine the portfolio and trade around core positions as volatility impacts various names.

New Positions: LII
Position additions: AMBA, PCT, UBER, NTRA, Z
Position reductions: FB, ASML, UNH
Position exits: ABBV, FICO

New Positions

Lennox International [LII] - *Growth Equity's* newest position is Lennox, a US-focused HVAC supplier. In an effort to beef up our industrials exposure alongside UBER in the transports subsector, we identified the US residential HVAC industry as having an attractive setup with upcoming positive demand catalysts and relatively poor analyst expectations. The ducted A/C market is ~$15 billion in size, is primarily US-centric, and sales are ~75-85% replacement units. Analysts have been calling the end of the residential HVAC cycle for a while based on an average unit life of 15 years and timing relative to the 2005-2007 housing cycle bubble. From 2013-2020 industry revenue was growing ~8% per year, while expectations for 2022-2024 are closer -2% to 0% industry growth.

We see these estimates as conservative due to a couple of factors impacting the lifespan of A/C units. First, Covid-19 and the work-from-home ("WFH") policies had significant implications for A/C usage; Lennox indicated 2020 A/C usage was up 30% over previous years. Assuming 20% more usage for 2021 relative to 2019, and no future benefit from WFH (albeit highly likely that WFH persists for years to come), this would decrease the expected lifespan of A/C units from 15 to 12 years. Second, the objective reading of temperatures continues to rise, with the United States having another record-setting average summer temperature at 74 degrees, 2.6 degrees warmer than normal. According to a 2012 Nest report, the average A/C run time was ~5 hours at 70-75 degrees and 10.6 hours at 85-90 degrees. A linear regression implies a ~6% increase in run-time for each degree increase. Third, the rise in temperatures has not been equally spread domestically. Extreme temperatures have been especially concentrated in the West and in the Pacific Northwest. Seattle is a particular outlier, where 44% of the homes have A/C access relative to the nationwide average of 87%. We would expect this relative gap for A/C access to shrink considerably with the average number of 90-degree days up >300% in Seattle. Lastly, the next round of SEER requirements with 2023 regulatory changes should bring about additional demand for residential units.

Lennox is the most pure-play on the US residential HVAC market with >65% of its business from this segment specifically. We see opportunities for Lennox to grow faster than the industry and to take profitable market share. Timing is also ripening for Lennox in context to devastating tornado damage to its manufacturing facility in 2018, which hampered its store growth strategy. 2021 is the first year of growth in stores since 2018 and Lennox expects to add >100 stores over the next four years. Every 30 stores should add ~0.25% market share, with each 0.5% of market share adding roughly 3% of revenue growth. Another aspect to the timing factor, LII's biggest competitors, Trane and Goodman, are facing production issues due to COVID and the polar vortex. This all sums to additional growth for Lennox, which we see as upsides to current expectations over the next 12-24 months.

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 nineteen 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 seven 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.

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 timeweighted 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 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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