

May 24, 2018

### Asset Class

#### Equity

US Large Cap

### Conviction:



### Strategy Information

#### Investment Manager

ABC Investment Management

#### Firm Type

Majority Employee-Owned

#### Strategy Inception

December 2003

#### Strategy Assets\*

\$3.2 billion\*

#### Benchmark\*\*

Russell 1000 Index\*\*

#### Expected Tracking Error\*\*

3% to 5%\*\*

#### Holdings

30 to 50 stocks

#### Expected Turnover\*\*

10% to 30% annually

\*as of March 2018, per eVestment

\*\*SEI-designated

### Analyst Summary

ABC Investment Management (ABC) is an employee-owned boutique located in Anytown, Anystate, that spun out of XYZ Capital in 2007. Its flagship Large Cap Growth product is well-established but unencumbered with assets, and is managed by the firm's highly focused four-person investment team. The strategy seeks to own stocks of competitively advantaged businesses that can compound growth in their intrinsic value over long time periods while avoiding impairment of capital through drawdowns. The team has a strong understanding of the underlying philosophy and its potential behavioral pitfalls, and the process is generally supportive. We note its flexibility around quality and its desire to maintain guardrails around risk exposures both limit the intensity of the stability alpha source in the portfolio as well as the portfolio's ability to concentrate into its best investment ideas. Nevertheless, we view the strategy as a solid implementation of the stability alpha source in a core-growth context.

#### What We Like

- The Large Cap Growth product is the firm's flagship strategy and offers meaningful growth potential, and thus commands the team's primary focus.
- The ownership structure, with nearly all of the equity held by the investment team, creates a hospitable environment for its longer-term style.
- The team is highly devoted to its philosophy around wide-moat companies and is particularly attuned to the potential behavioral pitfalls of its approach.
- The team's laser-like focus on competitive moats is the backbone of its effective sell discipline.

#### What We Don't Like

- Some aspects of the process elements are highly detailed and well thought out, while other potential best practices are glossed over in the name of avoiding bureaucracy.
- The strategy is managed in a manner mindful of active risk, which helps avoid portfolio drawdowns but also limits the portfolio's ability to concentrate in the team's best ideas and thus its alpha potential.
- The team's senior investors also run the firm. While this ensures it retains an investment-first culture, and COO/CCO John Doe has been a big help operationally, the fact that the key investors wear multiple hats is suboptimal.

Philosophy	Process	People	Portfolio	Firm	Product	Performance
✓	⊖	✓	⊖	✓	✓	⊖

### Performance Drivers

The strategy's primary focus on wide-moat companies and long-term compounding of intrinsic value means that stability will be the primary driver of returns. This is likely to manifest through fundamental stability (high sales and earnings growth stability) as well as price stability (lower volatility and beta), though the approach is tempered for diversification purposes and thus intensities are moderate. We also expect security selection to offer balanced contribution due to the moderately concentrated nature of the portfolio and the team's security-specific work. The strategy should provide downside protection in volatile markets, particularly in stress and distress environments. We would expect it to struggle in early, value-driven recoveries and in late cycle, momentum-driven markets. It should keep pace or outperform modestly in expansion environments where competitively advantaged businesses see growth opportunities and good fundamentals are rewarded.

### Lifecycle Stage

Firm	Growth
Product	Growth

Alpha Source	Intensity
Value	Low
Momentum	Low
Stability	Medium
Selection	Medium

### Our Opinion

 Favorable  Neutral  Unfavorable

<b>Philosophy</b> 	The philosophy is not unique, but is based in sound, empirically supported principles around long-term compounding and the importance of avoiding impairment through drawdowns. The team members are avid students of behavioral finance and have a solid understanding of the philosophy and why it works.
<b>Process</b> 	The process is a sensible implementation for the philosophy, with a lot of attention paid upfront to selecting the right types of companies and then ensuring the sustainability of the companies' competitive moats through time. The group research structure encourages devil's advocacy (particularly given the small team and relationship among the team members), and several specific process elements have been woven in expressly to help avoid behavioral pitfalls. There is a healthy emphasis on introspection and continuous improvement, though we note some areas of the process are tighter and more thoughtful than others.
<b>People</b> 	The four-person investment team enjoys experience and stable tenure and is well steeped in the philosophy. We find the team possesses high awareness of the key decisions and pitfalls associated with the underlying philosophy and an introspective culture focused on self-improvement. The team is highly collaborative, with a balance of mutual respect between members and a willingness to challenge each other.
<b>Portfolio</b> 	The portfolio is a reasonable, almost "Goldilocks" representation of the philosophy. The 30- to 50-stock portfolio is neither too concentrated nor too diversified. Sector exposures tend to be rather benign and factor tilts, while befitting the approach, are modest in intensity. Although the portfolio construction and risk management are suitable, ABC might be handcuffing itself by not pursuing its philosophy more aggressively. Its desire to limit active risk may be limiting its ability to generate alpha.
<b>Firm</b> 	ABC is an employee-owned boutique with a decade of independent operations, stable personnel, and a critical mass of assets. It is controlled by the investment team—favoring ongoing prioritization of investments—but benefits from strong contribution to non-investment matters through its CCO/COO. While somewhat awkwardly divided between its investment office in Anystate and its remote operations office in Anotherstate, on the whole we believe ABC is structured favorably to execute its philosophy.
<b>Product</b> 	The Large Cap Growth product is the firm's flagship offering and represents the majority of its assets, so its success is very important. Moreover, the product has ample capacity for future growth and it thus likely to retain the bulk of the investment team's attention.
<b>Performance</b> 	ABC has moderately outperformed the Russell 1000 Index since inception. Its more recent relative performance against the core index has been better, but we note this is largely due to the tailwind to the growth style. That said, the strategy clearly showed its value during the global financial crisis ten years ago, and we note it has managed to hold its ground during the extended bull market, particularly given drag from its cash position.

Sample

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