# Mid Cap Growth

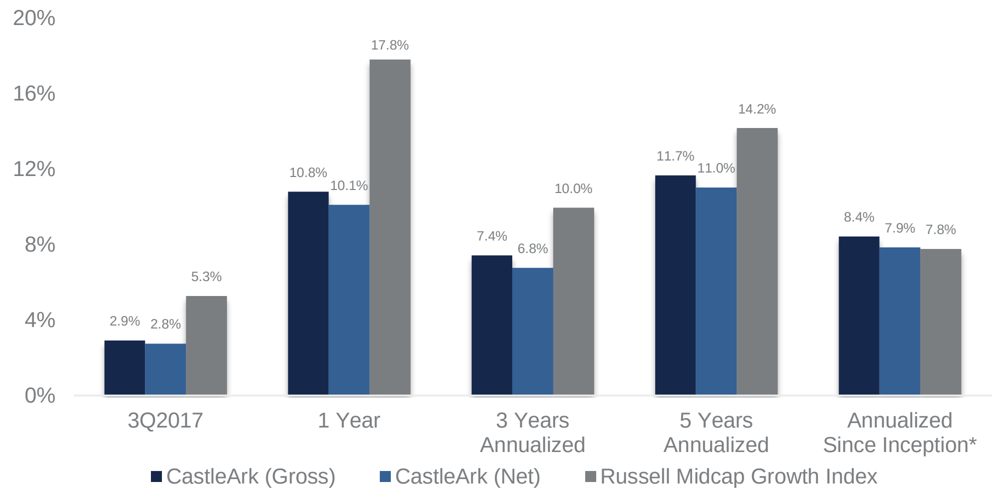
CASTLEARK

**September 30, 2017**

## Third Quarter 2017 – Performance Update

The CastleArk Mid Cap Growth Composite had a return of +2.93% gross and +2.76% net for the quarter, trailing the benchmark Russell Mid Cap Growth Index return of +5.28%. The continuation of strong economic data and strong corporate earnings helped growth stocks lead the equity markets steadily higher during the quarter, although weakness in our Consumer Discretionary holdings hurt returns, leaving year-to-date returns for the CastleArk Mid Cap Growth composite at +10.83% gross and +10.31% net, short of the benchmark return of +17.29%. Since inception, March 1, 1999, the CastleArk Mid Cap Growth Composite has outperformed with an annualized return of +8.44% gross and +7.86% net compared to +7.78% for the benchmark for the period ending September 30, 2017.

## CastleArk Mid Cap Growth Performance*




Past performance is no guarantee of future results.
*Inception 03/1/99

## Third Quarter 2017 – Portfolio Review

The September quarter was another good quarter for investors as global growth continued and S&P earnings surprised on the upside. The U.S. economy continued its slow and steady growth boosted by solid employment growth, low inflation, a weaker dollar and growth in Europe and China. Data released during the quarter has pointed to a strengthening in the U.S. and global economies. Surveys of companies point to better than expected revenues, S&P earnings are rising, U.S. and global leading indicators are stronger, foreign economies are reporting increases in GDP growth, consumer confidence continues to increase, bank loans are up, and global monetary policies remain stimulative. At the same time, inflation is at bay, allowing central banks to remain accommodative and allowing the Fed to postpone pending rate hikes. This slow and steady growth has frustrated many but may push the next recession further down the road and help the

## Top 10 Portfolio Holdings*

| | |
|---|---|
| Intuitive Surgical, Inc. | 11.6% |
| Fiserv, Inc. | 9.4% |
| Vertex Pharmaceuticals, Inc. | 5.9% |
| Starbucks Corporation | 3.8% |
| Trimble, Inc. | 3.6% |
| Southwest Airlines Co. | 3.4% |
| Cintas Corporation | 3.4% |
| Moog, Inc. Class A | 3.2% |
| Varian Medical Systems, Inc. | 3.0% |
| Gentex Corporation | 2.9% |
| **Percentage of Total Assets** | **50.2%** |

## Portfolio Characteristics*

| | CastleArk Midcap Growth | Russell Mid Cap Growth Index |
|---|---|---|
| Number of Companies | 47 | 420 |
| Forward P/E | 22.6x | 20.6x |
| Historical EPS Growth | 14.4% | 10.8% |
| Expected Growth | 10.3% | 12.0% |
| Return on Equity | 19.5% | 27.0% |
| Debt/Capital | 26.6% | 47.6% |
| Weight by Market Cap | $20.4B | $14.8B |
| Median Market Cap | $7.3B | $8.2B |

*Representative client portfolio.

## Mid Cap Growth Team

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## Third Quarter 2017 – Portfolio Review (continued)

stock market continue its upward trend. September was a month of natural disasters, including several hurricanes hitting the Caribbean Islands and the U.S. mainland and a major earthquake in Mexico City. While the hurricanes had a temporary negative impact on those local economies, the rebuild could be an incremental boost to the U.S. economy over the next few quarters, in particular for construction related businesses and the auto industry. Even the increased tensions surrounding North Korea's nuclear weapons program could not dampen the building optimism by equity investors across the globe that economic growth is becoming more durable, earnings growth is accelerating and the bull market is likely to continue.

It was another strong quarter for the equity markets, with the Russell Midcap Growth Index ending the quarter up +5.28%. The CastleArk Mid Cap Growth Composite return was up +2.93% gross, lagging the benchmark return by -235 basis points. Stock selection contributed the majority of the shortfall, -185 basis points, with sector allocation contributing the balance of the shortfall, -50 basis points. The zero weight in Consumer Staples, the weakest sector, did add +30 basis points but this was offset by the significant overweight in the 2nd weakest sector, Health Care, leading to a -55 basis point contribution. The underweight positions in the strong Information Technology and Financials sectors also detracted from relative performance with negative contributions of -15 and -14 basis points, respectively.

Stock selection was the biggest detractor from performance during the quarter. Although strong returns for select holdings in Health Care and Energy did add +225 and +51 basis points, respectively, underperformance by six of the seven Consumer Discretionary holdings, particularly the retail and apparel holdings, hurt performance by -205 basis points. Below sector returns for six of the seven Information Technology holdings cost another -108 basis points of relative return. Negative returns for large holdings in the Industrial and Financial sectors also led to negative contributions of -67 and -65 basis points, respectively.

At the end of the quarter, all ten of the worst contributing stocks during the quarter remained in the portfolio with no changes in position size.

## Outlook and Strategy

As we enter the final calendar quarter, our expectations have been confirmed; the U.S. economy is entering a period of sustainable Real GDP growth above 2.0%, and the world economy is in synchronized growth mode. As a consequence, growth acceleration is occurring globally, and we believe this will continue into 2018. This earnings reporting season carries higher expectations for third quarter results, as well as managements' guidance for

### Third Quarter 2017
Best and Worst Contributors*

| Best: | Contribution |
|---|---|
| 1. Intuitive Surgical, Inc. | 1.35% |
| 2. Vertex Pharmaceuticals, Inc. | .95% |
| 3. Fiserv, Inc. | .49% |
| 4. Moog, Inc. Class A | .47% |
| 5. Cintas Corporation | .43% |
| 6. Myriad Genetics, Inc. | .38% |
| 7. Trimble, Inc. | .36% |
| 8. Microchip Technology, Inc. | .35% |
| 9. RPC, Inc. | .29% |
| 10. Valero Energy Corporation | .19% |

| Worst: | Contribution |
|---|---|
| 1. Dick's Sporting Goods, Inc. | -.59% |
| 2. PRA Group, Inc. | -.48% |
| 3. Under Armour, Inc. Class C | -.46% |
| 4. Under Armour, Inc. Class A | -.40% |
| 5. Southwest Airlines Co. | -.40% |
| 6. Starbucks Corporation | -.32% |
| 7. DST Systems, Inc. | -.24% |
| 8. Stericycle, Inc. | -.20% |
| 9. Dentsply Sirona, Inc. | -.10% |
| 10. RPM International, Inc. | -.09% |

*Representative client portfolio. A complete list of security's contribution to performance and description of calculation methodology is available upon request.

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## Outlook and Strategy (continued)

the future. With the earnings reports will come stock price volatility, as usual, but we expect investors to take advantage of the “buy on weakness” opportunity more so than in prior quarters. Investor uncertainty has now shifted back to company fundamentals, versus the long persistent focus on the ebb and flow of between +1% to +2% GDP growth in the U.S. This has become an earnings driven stock market, with Price/Earnings (P/E) ratios unlikely to expand much further for the market as a whole. As anticipated last quarter, we believe the opportunity to generate very significant outperformance is developing as (1) the economic backdrop will produce an increase in the dispersion of reported results among companies as the relative financial returns on investments made over prior years becomes more evident in the form of positive earnings surprises; and (2) the premium paid for growth stocks continues to expand versus that for defensive/slow growth stocks given it is still well below historical norms.

We remain very positive on the continuation of the bull market, even though the market has set record highs. Earnings season is likely to create a period of consolidation for the market, short term. We recognize sentiment shifts will occur on macro events, such as tax reform, Central Bank actions, or geopolitical events, but we strongly believe the recent shift in investor focus toward company fundamentals will continue, allowing those companies with improving fundamentals to outperform their peers. Our focus is steadfast on owning companies that have heavily invested in new products, productive capacity, and distribution capabilities, as they have the best opportunity for stock price appreciation as returns on invested capital (ROIC), revenues, and earnings accelerate.

During the third quarter, no new stocks were added to the portfolio. One holding was removed from the portfolio, VCA Inc. which was acquired by Mars, Inc. during the quarter.