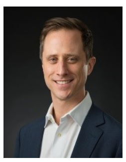
DYNAMIC GROWTH OPPORTUNITIES

Quarterly Update: 4Q2018

January 23, 2018



Michael Parker, CFA
Chief Investment Officer

The start of a new year makes for an opportune time to reflect, and with the understanding the equity markets in 2018 can be anxiety invoking for an equity investor. This update will address market volatility head-on, namely in our macro backdrop analysis. We see 4Q2018 as a period where price temporarily deviated from value, where inherently less liquid periods saw increased panic selling, and where a peak-to-trough draw-down of 20% delivered a correction many feared was imminent. Although we experienced a couple periods during the quarter where catching favorable bids seemed akin to catching a falling knife, we saw a growth vs. value year-end snapshot that mimicked the outcome of six out of the prior ten years. Despite finishing -1.5% lower across CY2018, growth held up better in total-return terms than its value counterpart, the latter of which netted -8.3% over the same period (see chart 1 below). We see the bottom-up drivers to this as remaining intact, a topic we've explored in prior white papers (here, here, and here). With technology growing increasingly pervasive across every market sector, rewarding its enablers with increased efficiency across various Opex and COGS line items, we find it increasingly critical to understand value creation with a lens calibrated for technological disruptions.

Table of Contents:

Chart 1: Calendar Year Return Analysis

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Russell 1000 Growth Indx	-38.4%	37.2%	16.7%	2.6%	15.3%	33.5%	13.1%	5.7%	7.1%	30.2%	-1.5%
Russell 1000 Value Indx	-36.9%	19.7%	15.5%	0.4%	17.5%	32.5%	13.5%	-3.8%	17.3%	13.7%	-8.3%
S&P 500 Indx	-38.5%	23.5%	12.8%	0.0%	13.4%	29.6%	11.4%	-0.7%	9.5%	19.4%	-4.4%

Source: FactSet. Total returns with dividends reinvested into respective indices.

Performance	4Q2018	3Q2018	Since Inception
DGO (net)	-17.1%	9.7%	-2.9%
DGO (gross)	-16.8%	10.0%	-2.1%
Russell 1000 Growth Index	-15.9%	9.2%	-3.8%
S&P 500 Index	-13.5%	7.7%	-4.3%
Russell 1000 Value Index	-11.7%	5.7%	-5.8%
Russell 2000 Index	-20.2%	3.6%	-12.2%

Source: FactSet and Schwab. DGO returns shown net and gross of management fees. Index performance reflects total returns with dividends reinvested into respective indices for periods ending 12/31/2018. Please see important disclosures on page 7.

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.

Aggregating the individual calendar years into compound annualized terms, one may observe return disparity between the two equity investing styles (chart 2). Although the delta may very well narrow going forward, we believe it is prudent for most long-term oriented investors to retain exposure to the "growth" equity asset class.

Chart 2: Compound Returns over the Prior Decade

Total Returns	1-Year	3-Year	5-Year	10-Year
Russell 1000 Growth Index	-1.5%	11.2%	10.4%	15.3%
S&P 500 Index	-4.4%	9.3%	8.5%	13.1%
Russell 1000 Value Index	-8.3%	7.0%	6.0%	11.2%

Source: FactSet. Annualized compound returns shown for periods greater than one year. Performance as of 12/31/2018.

Raison D'être: Alpha Delivery

In terms of the 53 positions held in our strategy, only four netted a positive return during the fourth calendar quarter. On a relative basis, 26 fared better than our index, as market volatility proved difficult to circumvent for any long-term focused investor. Below we dive deeper into issuer-specific drivers that aggregated to these portfolio results, looking at the top three contributors and detractors to DGO performance during 4Q2018 (each listed with price reaction for the period).

Contributors:

CME Group Inc. Class A [CME]: +12.0%

Overall, the financial services sector skews to the smaller exposures for our index, sector-wise, with the Russell 1000 Growth assigning a heavier weighting towards investment services and payment services issuers than traditional banks and insurers. Coming off a muted year of volatility during our strategy's pre-inception period, CME Group stood out as an attractive opportunity to gain exposure to a diverse derivatives marketplace business. Demand tailwinds include large institutions increasingly looking to manage factor exposures via derivatives, high frequency trading demand, and risk mitigation practices among myriad market participants, all of which position CME better than the constituent list of mutual fund managers, online brokers (outside of Schwab), and more equity-focused marketplaces that comprise our underweights in financial services.

Workday, Inc. Class A [WDAY]: +9.4%

Workday is an issuer with a January fiscal year, and takeaways from its FY3Q ending October alleviated many of the concerns plaguing the stock coming out of 2Q. At its core, WDAY presents an opportunity to own a software company that was built cloud-native from the ground-up, run by former PeopleSoft executives with a track record for success, and a long-term runway to grab market share from large on-premise incumbents, namely Oracle and SAP. Due to its status as a highly anticipated IPO back in October of 2012, WDAY had a lot of its early success baked into its trading price, causing its fundamental growth to be offset by the stock’s multiple contraction across the three-year period ending in early 2017. As such, the stock largely went sideways, all while delivering impressive fundamental results. We believe the period of multiple erosion is behind WDAY, leaving its attractive growth prospects to translate into continued upside for shares, delivered by continued penetration of human capital management ("HCM") software and ability to cross-sell into enterprise financial software.

Merck & Co., Inc. [MRK]: +8.5%

Near the inception of our strategy, the entire pharmaceutical sub-sector was facing the full brunt of pressure from every political branch. Many members of Congress echoed concerns of their constituents on the horrors of opioid abuse, while the administration placed its cross-hairs firmly on pharmaceutical drug pricing practices. Therefore, we placed our pharma bets carefully, avoiding low-hanging fruit for these political risks and opting for exposure to companies with meaningful opportunities on life enhancement/extension products. Merck represents just that opportunity, with its leading I-O therapy treatment, Keytruda, targeting non-small cell lung cancer with additional indications and tumor types highly likely to be added to its use case. In addition to having an animal health portfolio that comprises 10% of revenue, MRK also has promising opportunities with Gardasil as vaccination for HPV, and with oncology therapies via Lynparza and Lenvima and their ability to be utilized as combination therapies alongside Keytruda. We believe all of this translates into promising growth to outward years for MRK, which should hold up much better than its pharma constituents, should any of the political headwinds strengthen.

Detractors:

NVIDIA Corporation [NVDA]: -52.4%

As the largest semiconductor index constituent heading into 4Q, NVIDIA is a stock to which we pay close attention regardless of our outright ownership status. Not owning it can be just as harmful to alpha generation as owning it. Heading into the quarter, we saw it prudent to err on the slight underweight side given the near-balance of the bull and bear case on the stock in the context of where it was trading. It is hard to find a semiconductor thesis with a more attractive growth runway, both in relative upside percentage and gross dollar opportunity of its addressable markets. The core of this is NVDA's parallel compute architecture that runs workloads across the largest webscale data centers, autonomous driving applications, and neural networks that are the backbone to artificial intelligence. Many of these opportunities began to be reflected in the stock's pricing, trading near 37x forward earnings at the start of the 4th quarter. Despite the attractive longer-term prospects that are still intact for NVDA, the stock suffered from the adverse impact of stalled cryptocurrency demand along with channel inventory glut, while its core gaming GPU segment decelerated to +13% YoY after posting +52% in the prior quarter. As often happens in nascent computing markets, the bridge to meaningful revenue opportunity can be a bumpy ride as companies shift resources from legacy (for NVDA: PC-based graphics) towards next-gen opportunities (data center and automotive). We still see NVDA as having a war chest of intellectual property, along with software code advantage with its CUDA-based ecosystem, all of which begs for a better entry point to revisit our slight underweight.

Square, Inc. Class A [SQ]: -43.3%

Square moved from top 3Q contributor to the list of top 4Q detractors largely on market volatility that punished many of the prior period's winners. In fact, it has gained back much of what it lost in 4Q with a 42% move off its December bottom. We booked some of our Square gains on October 4th as our overweight position increased, a move we occasionally take in the routine management of the strategy when outperformance of a position extends it beyond risk profile parameters. With Square, ownership of an issuer at such an early stage of cash flow sustainability inherently entails periods of volatility. Aside from the explainable transition of its highly-regarded CFO to take the CEO role of a pre-IPO company, it's hard to cite fundamental justifications of the peak-to-trough move in SQ shares, as both our assessment on its financial outlook, as well as sell-side analysts' assessment, improved over the quarter. This largely translates into a downdraft entirely administered via the stock's multiple deflation, causing price to deviate from the company's underlying value. Due to the thesis dynamics outlined in our 3Q letter, we remain bullish on Square's long-term opportunity to introduce card transactions to vendors who largely relied upon cash, to make its way up-market, and to cross-sell offerings that leverage the unique advantage it possesses in knowing the sales granularity of its merchant customer base.

Wayfair, Inc. Class A [W]: -39.0%

Another holding that flipped from prior top contributor--in this case during 2Q2018--Wayfair found itself among the detractors for 4Q largely as a result of undue pain infliction by higher volatility. In times of tighter liquidity, as calendar year-ends typically entail, short-term focused trading algorithms can reliably turn to issuers with recent periods of price appreciation that also trade at elevated multiples. In this case, Wayfair makes for an attractive pile-on target. However, as we've outlined in the past, evidence continues to present itself that Wayfair is carving out an attractive competitive moat in the home furnishings market, where bulky goods are more difficult to box and ship via UPS and FedEx. To that extent, Wayfair continued its CastleGate distribution facility build-out, bringing both UK and Germany online, which together represent a $125 billion market opportunity that's just now being opened. Globally, the company expects to end the year with 50% more CastleGate and last mile facility square footage than the prior year and now has 66% coverage in the US for large parcel delivery. We continue to believe that having dedicated focus on this market segment, being able to fulfill orders seamlessly, and being long housing-related exposure that's well-positioned for online fulfillment is a wise stance for our consumer discretionary exposure. As such, we continue to see merit to retaining our long-term bullish position on W shares. We also took a similar opportunity to book gains in our relative Wayfair overweight on October 4th by trimming our position and redeploying proceeds elsewhere within DGO.

Macro Backdrop

The fourth quarter of 2018 marked the period where the Fed removed the training wheels that it had been deploying for nearly the prior decade; at least that's the best way to categorize the market's perception. We recently put some context behind this in our December white paper. In the post-financial crisis period, bank balance sheets required repair, the job market needed to heal, a housing foreclosure glut had to be flushed, and factories had to slowly shift gears back towards optimal production levels. All of that added up to the Fed concluding that it needed to retain "accommodative" posturing, that is, up until early October 2018 when Chairman Powell ditched the term from his commentary. In isolation, this conclusion was largely foregone. In conjunction with a handful of impacts—1) escalating trade tensions with our largest nation-state partner, 2) a yield curve head-faking flatness, 3) a midterm elections balance shift, 4) the shuttering of the federal workforce as a border wall deal pawn, and 5) an expansion that was getting longer in the tooth—these factors stacked up as too burdensome for the equity markets to sustain. As a result, December earned its Grinch-envious badge of "Worst Christmas Eve ever," and retail investors bailed from equity funds at a record pace (see Chart 3 on next page).

Despite a soggy Times Square ball-drop that made the humans-as-sardines ritual appear even more miserable on our screens, 2019 has been a refreshing reminder on the underlying drivers to what equity prices attempt to reflect. As active equity managers, we're not hired to be optimists. We're here as impartial arbiters, bestowed with the fiduciary responsibility of our clients' capital (alongside our own) to make sense of the market's appetite for risk. In turn, we position our long-term bets with the explicit intention of providing relative value. We view the end of 2018 as being a reminder that the days of a rising tide lifting all boats, one that simultaneously inflates multiples indiscriminately, are artifacts of the past. Never is it prudent to stack a portfolio with investing acronym du jour--prepare for the "FANGs" to be replaced by the "PAULs" of Palentir/

Airbnb/Uber/Lyft--as peak-to-trough draw-downs of 20% intra-quarter are not-so-gentle reminders that a risk-centric approach is imperative to the generation of attractive risk-adjusted returns. We interpret the market's 4Q volatility as a cue that our tools deployed towards relative value creation need to be sharper and more precise than any prior expansionary period.

Chart 3: Weekly Fund Flows ($M)

Source: EPFR, cited via Financial Times.

The disclaimer of past performance not being indicative of future results is one plastered across every financial publication containing any hint of financial advice. And, although it's an assumption that market technicians hold as truths, we find utility in observing the past in the exercise of context. Take, for example, current concerns that we're approaching a bubble burst, specifically one associated with lofty equity prices. Diving into the setup that created the "dot-com" boom/bust is a helpful comparative exercise to gain context on the pricing of the current environment. If you dissect the S&P 500 as of August 2000, a snapshot immediately prior to the two-year downturn that eroded 47% of market cap peak-to-trough, you would see significant bloat in trading multiples. This was especially pronounced among the large caps, as the ten largest issuers traded 64.6x earnings on average, while the overall market averaged 25.3x (see chart 4 on next page). Today's top ten list averages 25.9x, a 60% discount to the Aug 2000 period, while the overall market trades 17.1x, 32% cheaper. We simply are not facing the same level of pervasive, nose-bleed valuations.

How companies were deploying technology at the turn of the century in comparison to today also translated into significantly different value propositions. As of August 2000, Time Warner was consummating its $160 billion acquisition of AOL, a business that represented the common means of US household internet access at the time. All that a company had to do was slap ".com" onto its corporate banner, and the market subsequently rewarded the move with instant multiple appreciation. Companies also had to face large Capex deployments in order to set up a distributed computing environment inside a company-owned data center. Today, we can convert what otherwise would have been multi-million dollar Capex outlays to variable-cost-based compute workloads, metered by the compute minute from the likes of Amazon AWS, Microsoft Azure, or Google Cloud Platform. In 2000, traditional fundamental valuations were also eschewed as antiquated, with greater emphasis being placed on pre-revenue type metrics, such as counting eyeballs and clicks. This all summed to a market topography that was becoming increasingly top-heavy at the end of the summer of 2000.

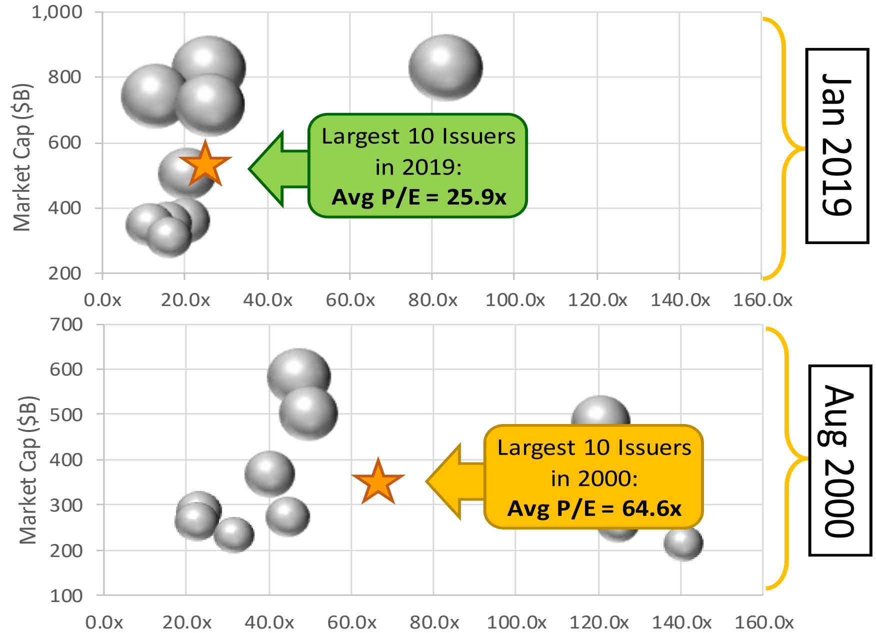
About the Author

Michael Parker, CFA
Chief Investment Officer

Mike joined SWS in 2017 as its CIO and leads portfolio management, risk management and research for the firm. Before joining SWS, Mike was a portfolio manager on $4 billion of long-only equity portfolios at the Ohio Public Employees Retirement System (OPERS).

He leverages over sixteen years of experience on both the buy-side and the sell-side to bring an institutional research and portfolio management framework for SWS investors today. 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.

Chart 4: Market Valuations: The S&P 500 in 2000 vs 2019



P/Es presented on a trailing-twelve-month basis. Average P/Es represent simple average of ten largest issuers in respective periods with positive earnings.
Source: FactSet, company filings.

Summary

All that said, we're not advocating investors draw the "2000 conditions don't exist" conclusion and march onward with a risk-on game plan. Since the tools to deconstruct business models are far more robust and data-intensive than they were at the turn of the century, we will always have to project financial outcomes further into the future, beyond periods where traditional forward-looking multiples may capture. However, even holding ourselves captive to the constraints of these analyses, we conclude that we are not currently suffering from bubble-inducing price inflation. Instead, we draw the conclusion that fundamental forecasts will require increasing due diligence and assumption stress-testing. As we run analyses tools across the opportunity set of our investable universe, we continue to see attractive opportunities for relative value creation and, as such, are optimistic about DGO's prospective opportunity.

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. DGO 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.

This material is not intended as and should not be used to provide investment advice and is not an offer to sell a security or a recommendation to buy a security. This summary is based exclusively on an analysis of general market conditions and does not speak to the suitability of any specific proposed securities transaction.

This investment strategy is subject to management risk such that no assurance may be given that the portfolio's value will be more than the original investment. The investment return and principal value of SWS Partners, LLC portfolios will fluctuate as the stock and bond markets fluctuate such that an investor's shares and/or portfolio value, when redeemed, may be worth more or less than their original cost.

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.

Diversified portfolio strategies do not assure or guarantee better performance and do not eliminate the risk of investment losses. It should not be assumed that any security holding shown was or will be profitable. The portfolio's holdings and allocation are subject to change based on the discretion of SWS Partners, LLC. This strategy is newly–launched by SWS Partners, LLC and has a limited operating history. As a result, SWS Partners, LLC has a minimal track record or history on which prospective investors may base their investment decisions. Different types of investments involve varying degrees of risk and there can be no assurance that any specific investment will be suitable for a client's portfolio. Investors should consider the risks, charges, and expenses carefully before investing in this or any other strategy. Investors should ensure the strategy presented fits within their investment objectives.

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.

All opinions and views mentioned in this report constitute our judgments as of the date of writing and are subject to change at any time. We will not advise you as to any change in figures or views found in this report.

Our judgment or recommendations may differ materially from what may be presented in a long-term investment plan. Investors should consult with an investment advisor to determine the appropriate investment strategy and investment vehicle. Investment decisions should be made based on the investor's specific financial needs and objectives, goals, time horizon and risk tolerance.

Security information, portfolio management strategies and tactical decision processes are opinions of SWS Partners, LLC and the performance results of such recommendations are subject to risks and uncertainties.

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.

Investment advisory services offered through SWS Partners, LLC.

https://swspartners.net info@swspartners.net (614) 670-5733