SWS Growth Equity

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.

As of December 31, 2023

Inception
March 1, 2018

Benchmark
Russell 1000 Growth Index

Portfolio Managers
Michael Parker, CFA & Kurt Grove, CFA

Firm Overview

SWS Partners 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.

Additional Resources

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Audio version →
available on Spotify

For the fourth quarter of 2023, SWS Growth Equity returned +17.67% net and +17.91% gross of fees, compared to +14.16% total return of the Russell 1000 Growth Index, our strategy's stated benchmark. The S&P 500 returned 11.69% over the same period.

We're not huge fans of spending a ton of time glaring in the rearview, but fourth-quarters naturally lend themselves opportunities to take stock on the prior year. The seasoning nature of this period also happens to anniversary all lumpy calendar impacts from personal consumption (e.g. holiday demand) and business fiscal year planning cycles (e.g. Q4 budget flushes), which also make for decent reflection opportunities. The January effect also sets customary bait traps for macro prognosticators to chime in with their gut feels on how the prospective year in global markets will progress. To that extent, 2023 was the year that shouldn't have been, at least for our asset class. There were very few factors that most rationally minded investors would have predicted to offset the albatross that was the collective slate of overhangs the market would face all year. Not that we traffic in making calendar year market calls, but our analysis of how decoupled pricing had become from intrinsic values following 2022's aftermath was more accurate than the market was reflecting at the time. **The silver lining to our assessment today: the go-forward environment continues to contain ripe opportunities for investors with a patient process of discerning where the most dramatic pricing deviations lie,** despite some goodness reflected in last year's recovery.

To gain a sense of how distorted the macro lens was this time last year, Wall Street banks' market forecasts took a buckshot-on-dartboard approach to forecasting S&P 500 Index results as of this time last year. In fact, we saw the widest spread between the highest and lowest estimate since 2009, with the street calling for a range of -17% to +10% in S&P levels by year-end 2023. It also marked the first negative average forecast for the market since 1999. As we're well aware, the index's 4,770 close on December 31st marked a 26.3% total return on the year. **While it's a bit harsh to assign scapegoat status to the macro forecasting herd, few could blame their cautious stance. Our slate of macro factors to navigate was downright daunting.** Top contenders included an inverted yield curve all year; our largest bank failures since the GFC; multi-region geopolitical unrest via Hamas/Israel, Russia/Ukraine, China/Taiwan; $1.6 trillion of federal student loan debt that reinstated monthly payments; credit card delinquency rates hitting their highest mark since 1Q2012; a 30-yr fixed mortgage rate that revisited its Nov 2000 high; just to name a few. Not many gainfully employed strategists would accept these premises and turn around to assign rosy forecasts given the many fires needing extinguishment.

That said, it's always tough sledding for those trafficking in the macro to have a finger on the micro pulse, which is the precise signal source of mispriced fundamentals. Getting an edge here requires tedious sifting through issuer financials and underwriting their business prospects via model forecasting. It also entails talking to the executives attempting to lead teams and execute strategy, interviewing competitors and suppliers, and putting yourself in the shoes of the executives tasked with shareholder value creation. This then allows the fundamental investor to compare optimal capital allocation to that which is occurring. The collection of all these efforts across the publicly traded universe is precisely what aggregates to the outcomes that PhD economists and Federal Reserve governors attempt to forecast.

To that extent, headline results continue to fail us in signal delivery by suggesting the market is too optimistic in its forecast of the Fed's soft landing attempt, a feat that rarely occurs. At 19.6x forward earnings, the S&P doesn't exactly scream bargain discount levels appropriately reflecting our previously noted slate of macro risks. Yet, for some reason, the message doesn't seem to resonate that we need to recalibrate our customary "risk on/off" calculus to a new(ish) source of pricing distortions. How quickly eye-roll momentum basket monikers—"magnificent seven" being our modern FAANGs or CANDIES—while putting little thought into their out-sized impact on our market-cap-weighted proxies, like the S&P 500 or Russell 1000. We've covered this in prior quarterlies, but the latest update continues to show historic valuation disparities by the ~490 issuers outside of the top S&P constituents, the latter of which is home base to the "magnificent" trillion-dollar market caps. **Once extracting the top 10 from the S&P, the remaining trade a more reasonable 15.0x forward earnings as of the end of 2023.**

We also can point to evidence of how far the pendulum had shifted last year via data from our portfolio issuers. Individual names yielding upside to our portfolio's mean of 37.9%/39.0% net/gross on the year shared a common theme of overly bearish forward expectations trading at overly compressed valuations. The top of this list sits META, which saw a 116% increase in forward earnings estimates across 2023, which in turn was rewarded with a 36% upward revision in price-to-earnings ratio. Fundamentally, the company also dispelled fears that we'd never see run-rate free cash flow carry a 3-handle (in $billions) again due to, as bears posited a founder-CEO who is hellbent on throwing billions down a blackhole to build the metaverse. It is a bit alarming to see internet companies with capex outlays far surpassing our largest oil and gas producers, but it speaks to ROI potential that carries both near-term and long-term implications. To that extent, META has done a solid job delivering on progress, while also demonstrating adaptability to quickly pivot towards operating efficiency.

Cherry-picking outperformers is easy, but the message from underperformers that we've retained in our portfolio also shares a common theme. They all represent opportunities for future expectations resets, specifically ones that we see strong odds of repricing in our favor over the next year and beyond. Our detractors analysis covers some of these in greater detail, but a common question when discussing issuers in the underperforming cohort is how to distinguish a temporary blemish/setback from thesis violations that require position exit. This is where investment process durability comes into play. **Our north star is economic value creation that results in cash-on-cash returns exceeding companies' weighted average cost of capital. The tools for issuers to achieve this increasingly rely upon extracting insights from data, but a key pillar for any company's success is to retain or take profitable market share.** In some environments, the market affords tremendous leeway to seek a path to the profitable share promise land (i.e. during the free money environment leading up to 2022). In other environments (post-2022), line-of-sight for profitable returns over the next 12-, maybe 24-months, is required. In cases where odds materially weaken that an issuer will be able to maintain/take profitable share, our resulting analysis may conclude in a position exit. Recent examples of this include our holdings of Etsy, Inc. (Jan 2024), Masimo Corporation (Aug 2023), and Stitch Fix, Inc. (Jun 2022).

Among the issuers that were detractors for us last year that we retain today, the common thread to our underwriting conclusions is a push-out in expectations. For our top five detractors of 2023—PureCycle Technologies, Ambarella, MP Materials Corp, PayPal, and Match Group—we categorize their respective stock reactions as the market incorporating far higher odds for failure than is likely. **Of course by definition of trafficking in imperfect, public information as non-insider investors, we could be proven wrong. However, segments of the market containing the greatest controversy often coincide with the greatest reward opportunities.** We very much see this being the case among the 2023 detractors, and our diagnoses entail thesis reveals in reasonable timeframes, specifically ones that are likely to show runways to profitable market share.

If this narrative sounds familiar, it overlaps with our earlier META example from the end of 2022. It also pattern matches countless examples spanning decades of managing public equity capital. Our current market crossroads set the stage for a very intriguing backdrop to stock picking. **Opportunities for multiplier-type outcomes (e.g. >2x) among the trillion-dollar market cap club are far fewer than those among the sub-$100 billion club.** How to express these exposures at the overall portfolio level will likely be a significant determinant of success over the next three- to five-year period. Although we don't anticipate compounding last year's results in perpetuity, we do see an attractive road ahead for return potential, a conclusion informed by the underwriting of companies in our portfolio and our pipeline.

Raison D'être: Alpha Delivery

US equity markets delivered strong fourth-quarter returns, headlined by the S&P 500 (S&P) returning +11.7% to top off a banner 2023 of +26.3%. Returns for the quarter were relatively similar across the size spectrum, with small caps outperforming slightly +14.0%, mid-caps +12.8%, and large-caps +12.0%. Depending on issuer size, there was a divergence in the growth/value performance split. **Once again, the mega-caps outperformed, causing the top 200 growth index to significantly outperform its equivalent value proxy +14.1% versus +8.0%.** In the small-cap landscape, value outperformed, returning +15.2% versus growth at +12.8%.

On a sector basis, real estate, technology, and financials led the way in the quarter, all returning >14%, while energy was the significant laggard, falling to -6.5%. **For 2023, only two sectors outperformed the S&P at +26.3%, technology and consumer discretionary returning +66.9% and +36.9%,** respectively. On the other end of the spectrum, energy, consumer staples, and utilities were significant laggards, all delivering negative returns for 2023.

Shifting to our internal performance, ***SWS Growth Equity* had a strong quarter, returning +17.7% net and +17.9% gross of fees, bringing its calendar year 2023 return to +37.9/39.0%,** respectively. This outperformed the Russell 1000 Growth Index (RLG) and S&P for the quarter at +14.2%/+11.7% and split the two indices for 2023, which returned +42.7%/26.3%, respectively. The intentional decision to fade some of the mega-caps was a drag on relative performance, causing our weighted average market cap of $255.5B to deviate significantly from the RLG and S&P at $1.1T and $721B, heavily skewed by the weights of the Magnificent 7. We think this is the correct decision and are pleased with our results in light of the significant underperformance of the small-cap/mid-cap growth indices' total returns of +18.6%/+25.9% versus the top-200 growth index returning +46.6%.

Chart 1

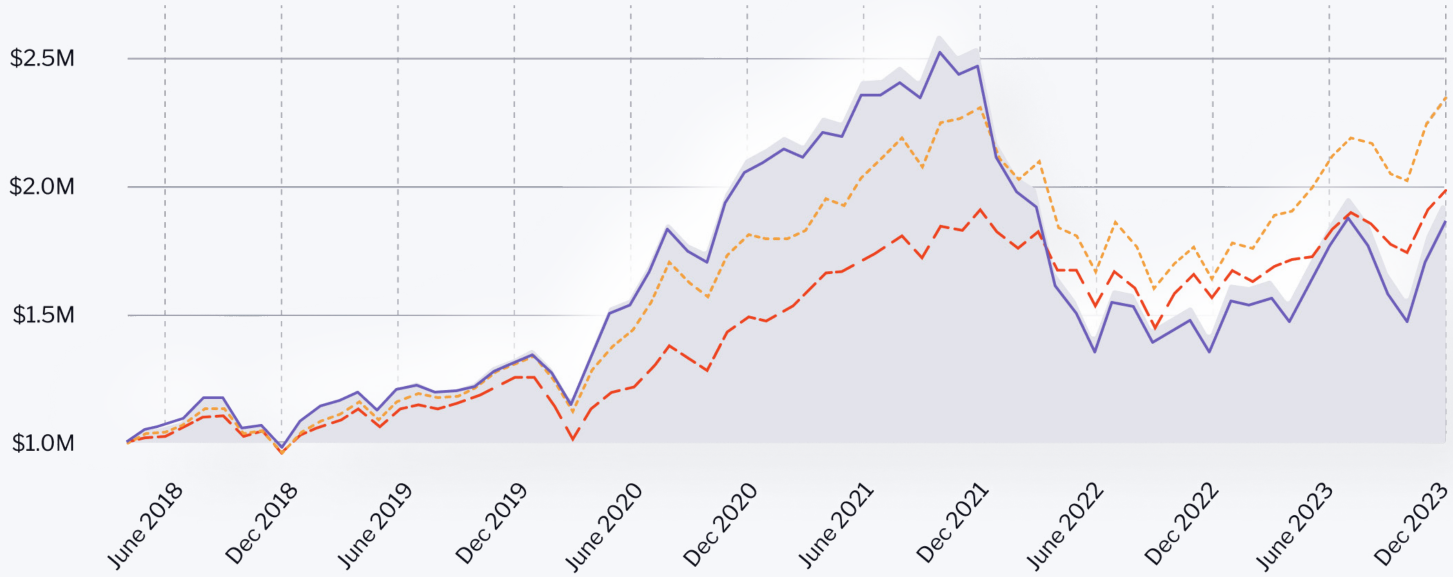
SWS Growth Equity Performance as of 12/31/2023

	4Q2023	YTD	1-Year	3-Year *Annualized*	5-Year *Annualized*	Since Inception *Annualized*	Since Inception *Cumulative*
SWS Growth Equity (net wtd. avg. fee)	17.67%	37.88%	37.88%	-3.26%	13.89%	11.64%	86.61%
SWS Growth Equity (gross)	17.91%	39.04%	39.04%	-2.44%	14.86%	12.57%	95.56%
Russell 1000 Growth	14.16%	42.68%	42.68%	8.86%	19.50%	16.22%	134.39%
Russell 1000 Value	9.50%	11.46%	11.46%	8.86%	10.91%	8.42%	58.10%
S&P 500	11.69%	26.29%	26.29%	10.00%	15.69%	12.85%	98.37%
Russell Midcap	12.82%	17.23%	17.23%	5.92%	12.68%	9.35%	65.99%
Russell 2000	14.03%	16.93%	16.93%	2.22%	9.97%	6.28%	41.25%
NASDAQ Composite Index	13.79%	44.64%	44.64%	6.04%	18.75%	15.06%	121.48%

Source: FactSet. Data represent total return (dividends reinvested into a respective index) for the period 9/30/2023–12/31/2023.
Please see important disclosures on page 9. SWS Growth Equity inception 5/1/2018.

Chart 2

Growth of $1 Million in SWS Growth Equity Since Inception



$1.96M SWS Growth Equity (gross)

$1.87M SWS Growth Equity (net. wtd. avg. fee)

$2.34M Russel 1000 Growth Index

$1.98M S&P 500 Index

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

BLOCK

SQ Block, Inc +**74.8%**

Block, a leading player in the US market for its person-to-person payment platform via the CashApp application and a leader in omnichannel retail sales via its Square Seller platform, had a strong performance quarter, returning +74.8%. **Our statement from last quarter that SQ was becoming "increasingly attractive"** on valuation and operational efficiency improvements took hold very quickly.

Block management clearly saw what the equity market was effectively "telling" the company with its depressed valuation. In the third quarter Block delivered strong operational results, growing gross profit at >20% and EBITDA approaching $2B annualized, complete with clear future quantitative messaging to the street. Targeting a "rule of 40" growth/margin profile by 2026, a firm cap on number of employees, Jack Dorsey (CEO and founder) stepping into to be the lead for the Seller business, and a $1B share buyback **all were clear messages about what the future investor should expect from Block.**

The sharp bounceback of +75% in quarterly performance stands in stark contrast to last quarter's -33.5% mark but only brought Block to a 2023 performance of +23%, and still, the equity remains 77% below its all-time high price. The ultimate goal remains to disrupt the payment processing rails and the digital wallet by intertwining the CashApp and Seller businesses. With a more operationally focused team, hardened by trials of 2022/2023, and a non-demanding valuation of 4.6x gross profit and 17x free cash flow, SQ's equity looks to be a worthy investment.

Top Contributor

shopify

SHOP Shopify, Inc. **+42.8%**

Shopify finished 2023 with a solid fourth quarter, returning +42.8% and +124.4% for the entire year. Looking at Shopify this quarter, coinciding with its first investor day since 2019, for which we were on-site for both investor days, presented an opportunity for us to have an internal investor reflection and to look at Shopify through a historical lens of our ownership.

Shopify represents a classic successful growth story. To oversimplify the premise: *identify a leader in a large and growing TAM, draw parallels to other business arenas to predict a future margin profile, heavily stress unit economics, and incremental margins, and finally purchase and hold the stock for an extended period.* **Growth is consistently underpriced by the market.**

The rewards to the investor have been significant since January 2018, the date of our original ownership at our predecessor strategy. **SHOP has returned +638.5% over these past six years, a >40% CAGR, versus the S&P, returning 96.5%, an +11.9% CAGR.** This significant outperformance, complete with a >80% drawdown and after a +135% 2023 return, is still 54% off its all-time high price.

Looking backward helps future underwriting for Shopify. In 2018, Shopify addressed ~4.5% of Ecommerce sales globally, Ecommerce globally was only ~9% of total retail sales, and Shopify's take rate of gross merchandise volume (GMV) was at a 1.48% clip, all adding up to an addressable market of ~$80B. At the time, there was a healthy debate if Shopify could move up the market to address larger merchants and if they could continue to outgrow the Ecommerce market. Fast forward to today, Shopify's estimated TAM is >$800B, the Ecommerce market globally is 13-14% of total retail sales, and Shopify has a >8% global Ecommerce share. Quick math shows Shopify addressed ~30% of incremental retail sales while increasing its take rate ~50% to 2.22% and growing the cash flow margin from 1% to 12% at a >15% incremental rate.

The next twelve months' valuation metrics have always been a "challenging exercise" for Shopify. However, applying the math above to a simple DCF can help investors see the forest through the trees and envision what 2030 looks like. **We are all but assured** the next five years will have lots of trading volatility, newsy headlines, political turmoil, and geopolitical angst. **We are also fairly certain that consumers will prefer online to offline for retail goods consumption** and most likely will prefer this at a similar share shift as the past five years. Assuming the prior 75 bps share shift per year and the same 30% share win rate for Shopify, it could bring GMV >$600B in the next five years.

We think these numbers will ultimately be conservative because Shopify is entering the steepest part of the S-curve for adoption. At the latest investor day, Shopify gave extremely valuable information on win/churn rates, highlighting a 38:1 and 43:1 win/churn rate versus the competition. **Fast forward five years**, and it would not be surprising to see consensus metrics looking at a $800B+ GMV and a 20+% FCF profile for Shopify.

Top Contributor

intel

INTC Intel Corporation **+41.7%**

Intel's strong quarterly return of +41.7% boosted its yearly return to +90.1%, easily outpacing its peers via the semiconductors index (SOXX) at +67.1% for 2023. As we stated in our 2Q 2023 commentary, where we discussed our May 2023 initiation of INTC @$30.59, **we thought there were multiple ways to win.**

The three pillars of the investment were: 1) A change from the then market prescribed ~0% chance that Intel would execute on the 5 nodes in 4 years strategy and return to node leadership 2) A cyclical upswing for earnings revisions from the upcoming refreshed PC cycle 3) Arguably, the most critical geopolitical company to the United States and Europe was now eligible for a significant portion of the $123B in recently issued subsidies to rebuild semiconductor fabs on both continents 4) Additionally, the margin of safety was enhanced by a decade low valuation while the rest of semiconductors traded above their historical multiples.

We've seen progress on all fronts in the eight months since our investment. Intel continues to relay they are on time and on track to deliver on their 5 nodes in 4 years strategy, most recently indicating a significant customer has signed up for Intel 18A. 18A is a crucial node transition for Intel as it would complete the 5 nodes in 4 years strategy. It also introduces RibbonFET and PowerVia, fundamental architecture changes that Intel will handle better than current industry leader TSMC. Estimate revisions have trended positively, and the worst of the PC cycle seems behind us, with 2024/2025 revisions up 11/12%, respectively. Geopolitically, progress has been made with Germany approving the next wave of funding for Intel's fabs.

Top Detractor

GUARDANT™

GH Guardant Health, Inc. **-8.7%**

We last updated investors on GH in our 2Q 2023 update as a top contributor; this quarter, GH underperformed with a -8.7% return, bringing its calendar year 2023 return to -0.5%. **2023 was very much a "hurry up and wait"** year for Guardant, with all investors focused squarely on the 2024 FDA approval decision regarding Shield. Investors received an update this quarter with the announcement of a premarket approval application (PMA) for Shield that will be reviewed on March 28th, 2024. This update was the main reason for underperformance this quarter. Investors were hopeful that Shield would not require a special panel to be called to discuss the new modality of liquid biopsy for screening purposes.

We are not surprised at this decision from the FDA. The implications of an early cancer detection tool via a blood draw will have dramatic consequences. Its application should be discussed thoroughly before an FDA approval is given or rejected. The timing of this PMA is in line with Guardant's expectation **and should not hold back FDA approval in 2024;** we expect it in the August-September timeframe. The PMA meeting and ultimate FDA decision will be the key drivers of future returns for Guardant for 2024. We expect Shield to be approved and then move to CMS approval by 2026. We have written extensively on Guardant in the past and would encourage investors to read our past writings for further context in 4Q 2022 and 1Q 2023.

Top Detractor

Visteon®

VC Visteon, Inc. **-9.5%**

Representing our most direct automotive exposure, Visteon underperformed this quarter, falling by -9.5% and delivering a return of -4.5% in 2023. For the entirety of 2023, Visteon mildly underperformed most of its automotive peers (GM, F, LEA, APTV, etc.) in 2023, all performing between -4% and +16%; TSLA being the large standout performer caused a drag on relative performance, returning +101%.

For Visteon, this quarter and year was a story of balancing the short-medium term with the long term. Rewinding to the last time we updated investors about VC in 1Q 2022, we talked about VC growing above market and winning significant deals in the wired/wireless battery management system (BMS) and digital clusters space. **This progress has continued, with new business wins hitting $5.8B YTD** above market expectations, a strengthened partnership with QCOM consolidating ECUs within ADAS/infotainment, and launching an automotive app store. Progress has been best exemplified by the 18 straight quarters of growth-over-market relative to customer vehicle production.

Unfortunately, VC performance and concerns lie with their core customers. Ford and GM had issues with union strikes and being supply-constrained this year, helping to reduce 2024/2025 earnings estimates by -8/-4%. Additionally, the declining share of Global OEMs within China is more of a longer-term headwind, where VC has less share. The two questions in the longer term are how far global OEM share falls within China and how successful Chinese OEMs are in selling into Europe and North America. **The latter question has far-reaching consequences** for many players within automotive and related supply chains, semiconductors, and commodity producers like *SWS Growth Equity* position MP Materials.

Top Detractor

PURECYCLE®

PCT PureCycle Technolgies, Inc. **-27.8%**

We have written extensively on PureCycle throughout our position ownership and would encourage investors to read our past pieces or reach out for more information because we will be brief in our write-up this quarter (2Q 2023, 3Q 2023, initiation piece).

Back-to-back quarters as a top detractor is **not how we pictured the back half of 2023 for PCT,** falling -27.8% in the quarter and -40% for the year. After the shutdown to replace the screen-changer in November, we expected to be in the “all-clear” phase finally and to see the plant ramping. We weren’t the only ones with most of the **upper management and board purchasing shares** in the open market. Unfortunately, this was not the case; on December 18th, PCT gave another update stating the plant had to be shut down again due to another mechanical seal failure and a leaking block valve.

So, once again, we are in the “wait-and-see” mode for Ironton to be up and running. We continue to believe the issues related to the plant are not related to the core technology of recycling polypropylene. The bull case for EBITDA per lb of polypropylene recycled continues to be above our original underwriting, and the case for investment remains strong. There have been significant changes in the timeline that we did not foresee. Still, we view the draconian bankruptcy scenario **as extremely unlikely** based on the minimal cash needed to pay off the existing bonds. We look forward to the next update from PCT. Numerous bullish catalysts can be provided related to their Asian/European operations and incremental funding from DOE. However, until the first plant at Ironton is up and consistently running, questions will remain, and the equity will be under pressure.

Author’s note: PCT issued an update after writing this piece above. We view the update as an incremental positive as production has resumed since December, and the ramp-up phase is progressing nicely. The update as of 1/16/2024, indicates a 4,700lb per hour production rate, ~38% of capacity, and well on the way to producing at 50% for 30 days by the March 31st deadline. Additionally, there will be an on-site investor day on March 7th in Ironton, and we think this will go a long way to dispelling much of the negativity surrounding PCT.

Portfolio Changes

New Positions	Position Additions	Position Reductions	Position Exits
	PCT, OKTA, AMZN	MTCH, NOW, META, TWLO, AMAT, UBER	

Michael Parker, CFA Partner, Chief Investment Officer

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 21 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.

Kurt Grove, CFA Partner, 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 nine 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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Performance results are that of the SWS Growth Composite. GIPS® Reports and additional disclosures for the related composites may be found in the SWS Partners GIPS® Reports. 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 asset weighting total returns of the strategy’s composite accounts. These results are geometrically linked monthly for all periods shown. Gross returns exclude advisory fees paid to the firm. Net returns include the deduction of composite accounts’ weighted average 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 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.

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The Russell 1000 Growth Index and the S&P 500 are market cap-weighted indices 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 madebased 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.