SILVERCREST
ASSET MANAGEMENT GROUP

The Case For Growth Investing

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1. CAPITAL APPRECIATION IN A SUB-PAR ECONOMIC ENVIRONMENT

Today's economic environment in the United States presents challenges to many investors. The United States economy has expanded at a 2.3% annual rate since the Great Recession, as compared to the typical non-recessionary pace of 4.2% since 1946. Investors are adjusting to this new normal by favoring growth stocks that present sustainable capital compounding opportunities. Our role as growth investors is to identify these business models, which are often disrupting the old guard and forcing change. As funny as it may sound, a low growth GDP environment bodes well for active growth managers. Dating back to 1930, small cap growth companies outpace their value counterparts when GDP growth is less than 3%. The same can be said when inflation is less than 2%. Both conditions are present today, despite central bank attempts to manufacture growth and inflation.

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In a low growth economic environment, the overall market tends to perpetually debate whether the next recession looms. Watching the forest from the trees makes it difficult for some investors to find high-quality growth investments. This is when we do our best work. The goal of growth investing is to identify scarcity value in small cap companies that are destined to become mid and large cap leaders. Much of this investor shift toward growth stocks since the Great Recession is attributable to the scarcity of cyclical growth in a debt-fueled economy that struggles with productive excesses around the world. The net reduction of nearly 40% of publicly traded companies since 1997 further contributes to the growth stock scarcity for public investors. As companies graduate to the mid and large cap universe, the small cap arena welcomes new companies every year. We find this dynamic attractive as active managers can identify companies that are constructing tomorrow's sustainable growers.

2. ENVIABLE 'FRANCHISE' COMPANIES COMPOUND SUSTAINABLE GROWTH

The hallmark of small cap growth stock selection is identifying companies with unique business models that enjoy outsized operating leverage without undue use of financial leverage. We believe that superior growth rates lead to rapid margin leverage which, in turn, the market rewards with higher multiples. The attributes of enviable profits are often born from investments in intellectual capital instead of physical manufacturing. Asset light is nimble, yet high-quality. To us, companies with unique franchise traits drive advantaged market share gains and pricing power due to outsized customer satisfaction. In turn, expanding profit margins and free cash flows propel capital reinvestment, strategic acquisitions and share repurchases. As the inertia of a successfully spinning flywheel drives further growth, these low capital intensity companies shine.

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We predominantly seek companies that have already proven out or perfected their ' secret sauce' and are methodically executing on a refined business model (i.e., stalking larger prey). These companies disrupt an industry via innovation and smartly reinvest capital to widen their moat. At the same time, larger peers often react slowly because they are defensively holding onto their market share. Successful small cap growth companies often share a "cheaper, faster, better" mantra as they pursue competitors who are disadvantaged by a legacy position.

Only on a limited basis do we own companies that one would classify as a turnaround or restructuring. Hoping for inertial improvement from a dead stop often drives a behavioral tendency to overestimate the probability of success. Our attraction to repeatable success from methodical execution leaves little room in the portfolio for long odds. In that vein, our appetite for binary outcomes from biotech or other new age startups is approximately zero. Let's find a proven, best of breed model that is humming along under the radar, we say. The four areas of Technology, Health Care, Consumer Discretionary and Industrials represent the deepest pools of opportunity for American companies to develop unique business models that compound shareholder wealth.

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3. HIGH-QUALITY EARNINGS GROWTH IS REWARDED BY THE MARKET

Many growth companies across the United States are thriving during this era of digital deflation. Widespread technology adoption by companies and consumers alike is driving a faster, cheaper and better assortment of products and services. As growth investors, we follow the money and ask questions to determine who is profiting the most. Who is voraciously spending and why? Where can technology adoption alter business processes and drive sustainably higher company profit margins? Which companies are winning because peers can't reinvest capital as smart, or at all? Which management team is consistently one step ahead? Said differently, which industries are adopting technologies and advanced business practices to thrive, and which ones are only reacting to survive? Our eight-person research team holds more than 1,000 private company meetings each year—and, in most cases, it is quite apparent if a company is the hammer or the nail in America's technology and intellectual-capital driven economy. Only when we understand the inner workings of a company can we gain comfort that we are investing in a high-quality company with staying power. Importantly, the maturation of investors since the dotcom bubble has fostered an environment where the market rewards pricing power, market share gains and expanding profit margins. Free cash flow generation, either now or in the future, is the standard by which we judge a company. To be sure, the market ultimately rewards a select set of small cap blue-chip companies.

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4. CAPITAL APPRECIATION AND PRESERVATION ARE NOT MUTUALLY EXCLSUIVE

Finding the intersection of value and growth is critically important when buying growth companies as we calculate potential appreciation and depreciation. So too is owning enviable assets that have more durable businesses when the economy cyclically sputters. Fellow investors are often on the sidelines waiting to buy high-quality gems during stock market pullbacks, which provides welcome support for our holdings. The byproduct of owning ' franchise' companies with stronger balance sheets and superior operating leverage is a portfolio with historically attractive upside and downside capture ratios. As such, a curated portfolio of unique growth companies should fare better than a passively managed index that is excessively burdened by overvalued, money-losing companies.

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