# FAM Equity-Income Fund *(FAMEX)*

FAM FUNDS

In-depth research. Insightful investing.

*Quarterly Advisor Commentary*

*for* **Professional Investment Advisors**
*data as of* **9/30/18**

## *Portfolio Managers*

**THOMAS O. PUTNAM**
*since 1/2/1987*

**PAUL C. HOGAN, CFA**
*since 4/1/1996*

## *Third Quarter 2018*

**TOP CONTRIBUTORS**
*(stock price change in %)*

| | |
|---|---|
| Ross Stores | 0.77% |
| Xilinx | 0.69% |
| CDW Corp. | 0.68% |
| Arthur J. Gallagher & Co. | 0.65% |
| Sonic Corp. | 0.57% |

**TOP DETRACTORS**
*(stock price change in %)*

| | |
|---|---|
| Microchip Technology | -0.54% |
| South State Corp. | -0.13% |
| T. Rowe Price | -0.13% |
| M&T Bank Corp. | -0.11% |
| Interpublic Group of Companies | -0.08% |

## MARKET AND PERFORMANCE REVIEW

Domestic equity returns were in firmly positive territory in the third quarter. In our opinion, market sentiment continued to be supported by robust economic growth and better-than-expected corporate earnings. As a result, stocks continued to grind higher despite the Federal Reserve's rate hiking trajectory and concerns around U.S. trade policy. The Fed raised rates by a quarter point on September 26, its third such increase of 2018, while signaling the likelihood of an additional increase before year-end.

The benchmark Russell Midcap Index returned 5.00% for the third quarter. Within mid-cap stocks, performance was led by the telecommunication services, healthcare, information technology, and industrials sectors, while returns for materials, real estate, financials, energy, and consumer staples lagged.[1]

The 7.61% return for FAM Equity-Income Fund in the quarter exceeded that of the mid-cap benchmark. The largest contributors to performance included selection within the consumer discretionary sector as well as an overweight selection to and selection within industrials. Selection within information technology and healthcare detracted modestly from return.

## NOTABLE FUND HOLDINGS

- In terms of individual names, off-price retailer **Ross Stores (ROST)** had the largest positive impact on the Fund's performance during the quarter. Off-price retailers, in general, have continued to do well and Ross reported better-than-expected growth in both same-store sales and earnings. In addition, guidance for the full year was increased.
- Semiconductor company **Xilinx (XLNX)** was the second largest contributor to performance. Investors seem to be growing more confident that the company could show strong growth with products used in data centers as well as 5G wireless applications.
- **CDW Corp. (CDW)** – a provider of technology products and services to businesses, the government, and educational institutions – was the third largest contributor to performance. CDW offers expertise in mobile, security, networking, cloud, and collaboration solutions. Management continues to execute flawlessly, and the company is growing faster than the overall information technology market largely by taking share from smaller competitors which lack the same breadth of expertise.
- **Microchip Technology (MCHP),** a manufacturer of memory and processing components used in a wide range of electronic devices, was the largest detractor from performance during the quarter. Management indicated that sales from the recent acquisition of MicroSemi would be lower than expected for two or three quarters as excessive inventory at distributors is brought down to more normal levels. As a result, paydown of the debt incurred to fund the acquisition will be delayed. In addition, there are concerns about a turn in the cycle for semiconductor companies.

[1] *FactSet 9/30/18*

## Top 10 Holdings

| | |
|---|---|
| CDW Corp. | 7.43% |
| Stryker Corp. | 5.85% |
| Air Products & Chemicals | 5.60% |
| Ross Stores | 5.33% |
| Arthur J Gallagher & Co. | 5.27% |
| Ingersoll Rand | 4.49% |
| EOG Resources | 3.83% |
| Xilinx | 3.72% |
| IDEX Corp. | 3.65% |
| US Ecology | 3.57% |

## Portfolio Information

**FAMEX** *(Investor Shares)*
**CUSIP:** 314465204
**Inception Date:** 4/1/1996

**Fund Size:** $259,668,582

- Regional bank **South State Corp. (SSB)** was the second largest detractor from performance. Earnings estimates for South State moved lower after the company reported second quarter revenue and earnings that were below expectations.
- Investment manager **T. Rowe Price Group (TROW)** was the third largest detractor from performance. While the company reported good earnings for the second quarter, growth slowed relative to the previous quarter. We believe T. Rowe is on track to have its best year of inflows since 2010.

## PORTFOLIO ACTIVITY

- Over the quarter, we added to existing positions in pressure sensitive label manufacturer **Avery Denison Corp. (AVY)**, global industrial manufacturer **Ingersoll Rand (IR)**, and regional bank **M&T Bank Corp. (MTB)**.
- We initiated modest positions in **International Flavors & Fragrances (IFF)** and **Watsco (WSO)**. Both names have been terrific compounders over the years. IFF manufactures flavors and scents used in thousands of food, beverage, and cosmetic products. We initiated our position in IFF after the stock sold off on the announcement of the Frutarom acquisition. While there may be some integration pains, we believe the acquisition increases the growth profile of the company. We view Watsco as the “best of breed” in HVAC distribution, and expect that their investments in technology designed to aid service technicians should further distinguish this company from its peers. We are awaiting a better valuation to further build our position.
- We sold our entire position in dental and animal health distributor **Patterson Companies (PDCO)**. We have come to view the competitive position of the company as permanently impaired.
- Cash was 5.52% of the portfolio at the end of the quarter, up modestly from the prior quarter.

## OUTLOOK

Our outlook is largely unchanged from last quarter. We continue to monitor the extent to which the trade war impacts economic growth and corporate profits. At present, in our opinion, economic activity remains strong and consumer and business optimism are at record highs. This is showing up in revenue growth for the companies in the Fund. In addition, in some cases, the new lowered tax rate is providing a meaningful boost to profitability. Companies are using the additional cash flow to invest back into businesses and undertake projects which in the past might have been capital-constrained.

We are cautious about valuations at current levels. As always, our team continues to seek to invest in good businesses, which we believe should compound over time, at prices below what we think they are worth.