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Focused Growth

Polen Capital has a strong track record investing in high-quality growth stocks priced just right.

UNDISCOVERED MANAGER

Tom Lauricella

In every issue, Undiscovered Manager profiles a manager on the Morningstar Manager Prospects list, which is compiled by Morningstar's manager research group.

Conventional wisdom has it that investors in a concentrated stock fund filled with high-growth names would be in for a wild ride as the portfolio's small number of names swing in and out of favor.

But Polen Capital Management has shown it doesn't have to be a white-knuckle experience if the risks of owning fewer stocks in a portfolio are spread among high-quality companies.

The firm's five-year-old Polen Growth POLRX—which employs a strategy the firm has been running through separate accounts for 27 years—has chalked up competitive returns with low volatility. The $808 million mutual fund has returned an average of 13.7% a year since its launch in 2010 through December, ahead of the S&P 500 and beating 86% of its peers in Morningstar's large-growth category.

In 2015, the fund returned 14.4%, more than 10 times that of the S&P and four times the average fund in its peer group. The portfolio had broad-based gains, including Alphabet GOOG (formerly Google), Starbucks SBUX, and Nike NKE.

Portfolio managers Damon Ficklin, Dan Davidowitz—who also serves as the firm's chief investment officer—and the rest of the seven-person investment team hunt for companies they believe have the ability to generate sustainable, high levels of organic earnings growth. They do this by screening for stocks that meet a five-pronged quality test. From there, they'll spend many months vetting a company before including it in their roughly 20-stock portfolio.

"The real risk comes from investing in an inferior company," Davidowitz says.

Mauricio Gruener, co-founder and president of GFG Capital, a multifamily office located in Miami, has been investing with Polen since 2003. He describes the firm's approach as very defensive.

"Even if it's a concentrated strategy, it's a high-quality set of companies, and that gives you a margin of safety," says Gruener, whose firm has $1.1 billion in assets.

Building a Team

David Polen founded his firm in 1979 in Boca Raton, Florida, as a small broker-dealer focused on high-net-worth investors and family trusts. Polen launched the Focus Growth Strategy as a separately managed account in 1989. The strategy posted strong returns in the 1990s and outperformed during the bear market years of 2001 and 2002.

By 2003 Polen, who passed away in 2012, wanted to grow his firm as an asset-management business. He brought in Stan Moss, the firm's current chief executive officer, to help with the effort. He also hired Ficklin, who has a background in accounting, as his first analyst. (Ficklin joined Polen from Morningstar, where he was a stock analyst.)

In 2005, Polen hired Davidowitz, a former volunteer emergency medical technician who had gravitated from a career in medical business administration toward money management. After getting his MBA, Davidowitz cut his teeth on stock analysis at Value Line and then shifted to research at a deep-value money manager in New Jersey before joining Polen.

The firm's three portfolio managers, which also includes Julian Pick, who joined in 2014 to lead the launch of Polen Global Growth Investor PGIRX in 2015, also double as analysts. Along with four other investment professionals, all seven act as generalists, following a range of companies and presenting ideas to each other.

Growth With a Reasonable Approach

The process for picking stocks starts by screening the large-cap universe for names that measure up on five metrics: strong revenue and earnings growth, return on equity consistently topping 20%, strong balance sheets with debt equaling less than two times free cash flow, high levels of free cash flow, and stable or increasing operating margins.

Generally only about 200 to 300 companies out of the Russell 1000 universe can pass the initial screens. As the managers dive deeper, Davidowitz says about 125 companies generally make it to their watch list. "That's our stocked pond," he says.

The result is the ability to choose from companies with the potential for strong, organic growth that

Polen Growth POLRX

Category	**Large Growth**
Expense Ratio (%)	**1.25%**
Morningstar Rating	★★★★★
3-Yr Annl Total Rtn (%)	**17.5**
3-Yr Total Rtn % Rank	**18**

Data as of 12/31/2015

isn't cyclical or driven by acquisitions and share buybacks. At the same time, the process provides a roster of companies they can have a high degree of confidence in. "The antithesis of that are companies that bring in risk to the portfolio," Davidowitz says.

In an effort to add an extra layer of cushion, the portfolio generally holds a few names the managers consider especially stable, such as Nestle and Abbot Laboratories ABT.

Performance Matters

The firm's strategy does involve something of a trade-off in that it will tend to lag during big stock rallies that are led by lower-quality companies, or periods such as 2013, when the broad market ran far ahead of earnings growth.

Performance of the fund shows the philosophy in action when it comes to preserving capital. Over the past five years, Polen Growth captured 91.9% of the market's upside compared to 99% for the large-growth category. But the fund captured just 73.3% of the market's losses compared to 105.2% for the peer group.

It's a similar story for avoiding damaging volatility. The fund's Sortino ratio, a measure of volatility that is focused on downside performance, is 2.5 for the past five years compared to 1.6 for large-growth funds. (A larger Sortino ratio indicates less of a chance of a large loss.)

GFG Capital's Gruener noted the separate account Polen Focus Growth was down 27.8% gross of fees during the financial crisis year of 2008, when the Russell 1000 lost 37.6%. "That was very important to us," he says.

Over the past 10 years, the Focus Growth separate account returned an average of 11.8% per year gross of fees compared to 7.8% for the average large-growth strategy.

Polen's **Damon Ficklin** and **Daniel Davidowitz** focus on growth and safety.

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Polen CEO **Stan Moss** has carried on his firm's tradition of a collaborative and client-focused culture.

Polen Growth's strong performance in 2015 mirrors the earnings gains generated by the companies in the portfolio. Through the third quarter of 2015, the weighted average earnings growth of the stocks in the portfolio was about 17%. Meanwhile, S&P 500 earnings have been basically flat. Over the long term, Polen estimates the portfolio's weighted average earnings growth rate has typically been in the 13% range, roughly double the S&P 500's long-term trend.

Among the main contributors to the fund's strong performance last year came from Alphabet/Google, which jumped 44.6% in 2015.

"We love companies that have massive competitive advantages, massively strong balance sheets, and a big secular tailwind behind them—and Google has all of those," Davidowitz says. Polen first bought shares in early 2008.

At the end of 2014, the fund had an above average postion for the portfolio in Alphabet at about 7%. The stock was down 5% that year while the S&P 500 rose nearly 14%. The managers thought other investors were caught in the short-term noise around the company's spending. "Google was executing," says Davidowitz. They took the stock up to an 8.5% position. (The fund finished the year with nearly an 11% weighting in the stock.)

Two other significant winners were Starbucks and Nike. "Both companies are great franchises hiding in plain sight," Ficklin says.

Nike was the third largest holding behind Visa V for the fund as of year-end, with a 7.2% stake. Nike rallied 31.2% in 2015. Starbucks was the portfolio's fourth largest, at 6.3% of the fund. Shares of Starbucks surged 48% in 2015.

Facebook FB has also provided a lift. The managers thought that given its growth prospects the valuation was justified at what they estimated was 40 times forward earnings. Polen first bought the stock in July 2013 at about $36. But by February 2014, the stock had roughly doubled and was trading at more than 55 times forward earnings.

The managers sold the stock just south of $70 a share. Then in May, they stepped back in around $80 a share. They believed that earnings growth had caught up with the stock price, which was once again trading at a valuation in the mid-30s.

Such churn is very unusual for the fund; turnover is 33%. The managers say that percentage is historically much lower. They invest with a five-year time horizon, and since 1989, between the separate account and mutual fund, the strategy has owned only 105 different stocks.

However, the managers won't hesitate to jump out of a stock if they think that a company's franchise is in jeopardy. The fund owned American Express AXP for 14 years but sold it in January 2008. The managers believed that the company had shifted away from its tried-and-true charge-card business, which had a low level of delinquency risk, and was moving into a riskier credit-lending business. That proved prescient ahead of the financial crisis, with the stock collapsing 63% that year.

They also bailed out of Qualcomm QCOM in September 2014, having owned it since 2008. They believed regulatory pressures in China threatened the company's core royalty revenue. Qualcomm lost 30% in 2015. "If there's a small chance of a big problem, that's enough for us to not be around in a stock," Ficklin says.

Well-Defined Culture

With the firm's strong track record have come inflows. The firm manages $7.5 billion, up from $970 million at the end of 2002.

Moss says that the firm is comfortable with the pace of growth given its large-cap and global stock focus. On the heels of launching Polen Global Growth, management is considering a pure foreign-stock strategy.

Underlying the investment approach is a well-defined culture, says Moss, who was the punter on the University of Alabama's 1992 national championship football team.

There's what they call "mastery," an effort supporting continuing education that is budgeted for all 33 of the firm's employees. One stock analyst took a seminar on the "butterfly effect," and operational employees have gone to Dale Carnegie training to learn how they can better communicate.

Autonomy is emphasized, he says. "We give our talent room to run," Moss says.

A key aspect of the firm's culture, Moss says, is maintaining a focus on its purpose. That's led to the creation of what they call the "why" wall, located in a central part of office where employees have coffee and lunch. On the wall are photographs of actual participants in the plans and organizations for which they manage money. "Every person passes through that room every day," Moss says. "They see front and center the reasons that they are here." M

Tom Lauricella is the editor of Morningstar Direct.

POLEN CAPITAL GROWTH EQUITY FUND (POLRX)

Period Ending 12/31/15					
	4Q 2015	**1 Year**	**3 Years**	**5 Years**	**Since Inception 9/15/2010**
POLIX	**7.78**	**14.65**	**17.75**	**14.12**	**16.11**
Russell 1000 Growth	**7.32**	**5.67**	**16.84**	**13.54**	**15.74**
S&P 500	**7.04**	**1.38**	**15.14**	**12.57**	**14.34**

The performance data quoted represents past performance and does not guarantee future results. Current performance may be lower or higher. Performance data current to the most recent month-end may be obtained by calling (888) 678-6024. The investment return and principal value of an investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. A 2.00% redemption fee applies to shares redeemed within 60 days of purchase. This redemption fee is not reflected in the returns shown above. Returns for periods greater than one year are annualized. The total gross expense ratio of the Fund as disclosed in the most recent prospectus is 1.50% and the net expense ratio after contractual fee waivers is 1.25% for the Investor share class (POLRX). For the Institutional share class (POLIX), the total gross expense ratio is 1.25% and the net expense ratio after contractual fee waivers is 1.00%. Polen Capital Management has contractually agreed to reduce its fees or reimburse the Fund's operating expenses in order to limit the total annual operating expenses. Total returns would be lower had such fees and expenses not been waived and/or reimbursed. This agreement will terminate on August 31, 2016, unless the Board of Trustees approves an earlier termination.

*The **Russell 1000® Growth Index** is an unmanaged index that measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® Growth Index companies with higher price-to-book ratios and higher forecasted growth values.*
*The **S&P 500 Index** is a widely recognized, unmanaged index of 500 common stocks which are generally representative of the U.S. stock market as a whole. It is impossible to invest directly in an index. The performance of an index does not reflect any transaction costs, management fees, or taxes.*

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Our complete performance disclosure is available on our website at: http://www.polencapital.com/pdf/Strategies/Polen-Capital-Focus-GIPS-Disclosure.pdf

The Polen Growth Fund received a 5-star Morningstar Rating based on Risk-Adjusted Returns for the, Overall, 3-year and 5-year periods as of 1/31/2016 among 1546, 1546 and 1325 Morningstar Large Growth Funds category.

The Fund was also ranked in the 1st percentile for the 1-year period and 3rd percentile for the 3- and 5 year periods based on Total Return.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk- Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance.

The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. The Overall Morningstar Rating is derived from a weighted-average of the performance figures associated with its three-, five-, and ten-year, (if applicable) Morningstar Rating metrics. Past performance is no guarantee of future results.

Risk Considerations

All mutual fund investing involves risk, including possible loss of principal. The Fund is non-diversified, which means that a large portion of the Fund's assets may be invested in one or few companies or sectors. The Fund could fluctuate in value more than a diversified fund

The securities mentioned (or referenced) in the article represent the following percentages in the fund's portfolio: Alphabet Inc. A 4.44%; Alphabet Inc. C 6.40%; Starbucks Corp 6.20%; Nike Inc. 7.06%; Abbot Laboratories 5.26%; Visa Inc. 7.42%; Facebook Inc. 3.60%; American Express Company 0.00%; Qualcomm Inc. 0.00%.

You should consider the investment objectives, risks, charges and expenses of the Polen Growth Fund carefully before investing. A prospectus with this and other information about the Fund may be obtained by calling (888)678-6024 or by visiting http://www.polencapital.com/products_pgf.php. It should be read carefully before investing.

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