

# GROWTH EQUITY REVIEW

*First Quarter 2014*

“The Pause that Refreshes”

## PERFORMANCE COMMENTARY

After an outstanding 2013, we see the first quarter of 2014 as reminiscent of the 1929 Coca Cola advertising slogan, “the pause that refreshes”. From our perspective, this quarter might be viewed as a period of assessment and consolidation since it was essentially a flat quarter. It was a series of fits and starts with short run swings in investor sentiment. The issues of sustainability of global growth, geopolitical risk in the Ukraine, uncertainty over the effects of Federal Reserve tightening, and continued domestic political discord contributed to investor anxiety. Continued growth in the US economy and corporate profits, however, provided offsetting optimism. The S&P 500 was up 1.88% for the quarter while Growth Equity, lagging the broad market slightly was up 1.31%.

	Periods Ending March 31, 2014					
	YTD	1 Yr	3 Yrs	5 Yrs	7 Yrs	10 Yrs
<b>Growth Equity Composite - NET</b>	<b>1.1</b>	<b>24.7</b>	<b>12.6</b>	<b>22.8</b>	<b>8.8</b>	<b>8.9</b>
Russell 3000 Growth Index	1.1	23.5	14.5	21.9	8.3	8.0
S&P 500 Index	1.8	21.9	14.7	21.2	6.3	7.4

Composite performance is reported NET of fees. Please refer to the disclosures at the end of this report.

Performance figures for periods one year and longer are annualized.

## PORTFOLIO COMMENTARY

Two strong performers from last year continued their strong performance again this quarter. **Morphosys (MPSYF)**, after almost a double last year, was up 20% in the quarter. Morphosys, based in Germany and a world leader in the development of antibodies to treat cancers and arthritis, benefited from the interest in biotech companies. **Corning (GLW)** was up as well, up 17% after being up 26% in the prior quarter. This was despite headline concerns over a new competitor for Gorilla glass. We own the stock for its next iterations of glass – Eagle (ultra thin) and Willow (flexible/bendable) glass. We see these as being transformative to the application of the use of glass and to the industry itself. **Hansen Medical (HNSN)**, which is a small position, has been on the leaders and laggards list numerous quarters. A laggard last quarter the stock was up 50% this quarter. As long term investors we are willing to live with this stock’s volatility because we see the enterprise value inherent in the company and believe it will come to fruition in either a significantly higher valuation or a take out by a larger health care company. **Union Pacific (UNP)** and **Computer Sciences (CSC)** were both up 11 and 9% respectively.

The laggards were simply the yin and the yang of last quarter, with four of last quarter’s leaders lagging this quarter. **Boeing (BA)** was down 8% (after being up 17%), **General Electric (GE)** was

down 8% (after being up 17%), **Unisys (UIS)** was down 9% (after being up 33%) and **Faro Technologies (FARO)** was down 9% (after being up 51%). We see **Biolase (BLTI)** and **Hansen Medical** as “Bobbsey twins”. They are both medical device companies developing new product offerings and have big opportunities ahead of them. However, both are volatile holdings and accordingly are small positions in the portfolio. **Biolase** was down 14% this quarter.

## PORTFOLIO ACTIVITY

At the end of March we made several changes to the portfolio. We trimmed our position in **Verizon (VZ)** to create a new position in **America Movil (AMX)**.

**Vodafone’s** sale of its minority position in Verizon Wireless spun out Verizon stock, as well as cash, to Vodafone holders. We had positions in both Vodafone and Verizon. We are essentially using the proceeds from the Vodafone distribution to fund the addition of AMX. America Movil is a mobile and fixed voice telecommunications provider. They are the dominant player in Latin America, with over 270 million cellular subscribers, offering wireline services and cable TV services to a potential of 892 million persons. While it is the dominant phone service provider in Mexico with close to a 70% market share, Mexico accounts for only 35% of its revenues. Wireless data and pay TV have been growing recently at double digits and revenues are projected to grow significantly faster than the overall economy. We are anticipating AMX to continue to benefit from an improving Latin American economy and a growing middle class. We also see them as a leveraged way to play the increase in smart phone sales and usage as well as the transition from 2G to 3G and then on to 4G for data transmission.

In doing so we retain the same exposure to the growth in demand trend for ever increasing data utilization and transmission, but tilt our overall exposure slightly away from yield and towards growth opportunities.

We also sold our position in **Novozymes (NVZMY)** replacing the position with two smaller weightings in **United Continental Holdings (UAL)** and **Mesoblast (MBLTY)**.

As investors, we like to invest in long duration demand drivers and changing circumstances, as change presents opportunity. We have been looking at the airlines with the old saw in mind, “one never makes money in airline stocks as they are not profitable entities”. However, we see significant change in the pricing of energy ahead and as well as recent changes to industry dynamics that should be and will be favorable to the industry. Now the wind is finally at their back, giving lift to the industry.

In this instance, rather than benefiting from an upwardly rising demand curve, it is a long duration downward glide in the price of energy that seems to be very beneficial to the airline industry. Between discovery of new fields of oil and enhanced recovery in existing fields, energy conservation practices, and strides made in the cost efficiency of alternative energy, we see the overall cost of energy declining. Declining fuel cost is the variable that can make the airline industry now profitable on an operating basis.

In past years the industry was extremely competitive. But after the recent domestic mergers, interlocking global alliances, and the regulatory hurdles and financial costs of entry for startups, it is unlikely that the industry will go back to being the competitive industry it was with continual fare war pricing.

UAL, benefitting from its combination with Continental Airlines domestically and international alliances, now has an excellent global route structure. It seems to be the best value vis-a-vis the alternatives.

Risk mitigation is a key consideration in all we do here. For Growth Equity portfolios we balance small rapidly growing, and frequently scientifically driven companies, against larger more secure growth companies to achieve a growth return but on what we see as a better risk adjusted basis. In this instance, we complemented UAL with a position in Mesoblast.

Mesoblast is engaged in the development of propriety stem cell technologies for use in the treatment of multiple major disease states. MBLTY is more robustly staffed than most stem cell development companies and addresses about the broadest of regeneration applications. Having a broad spread of opportunities attenuates and spreads the risk more than most investment alternatives. MBLTY uses cell-based core stem cells derived from purified blood and fat tissue sources to target treatment intravenously of cardiovascular diseases, including congestive heart failure. They are also developing stem cell treatment therapies for diseases of excessive inflammation and immune dysfunction, including type 2 diabetes, inflammatory joint diseases, and lung diseases; and products for treating eye diseases, neurologic diseases, and cord blood expansion. The company has strategic alliances with several significant bio tech companies to both produce its off-the-shelf (allogeneic) adult stem cell products and to develop and commercialize its products.

## **MARKET COMMENTARY**

Investors seem to have lost their proverbial compasses as to which relevant factors will determine the future value of financial assets.

The world is awash with negative fodder from the press and pundits, resulting in a muted level of investor enthusiasm. After the sharp bull market rise from the March 2009 lows, the great concern among investors now centers around a number of “quantitative” market measures; its five year duration making it long in the tooth, its 150+% gain positioning it as technically extended, and its elevated PE ratio and low absolute yield signaling valuation vulnerability. These “quantitative” concerns are exaggerated by the aforementioned economic and geopolitical issues.

The assessment of stocks should not be overly influenced by rigorous “quantitative” models, but instead on a deeper inspection of the “qualitative” factors that will influence their futures. What are the “qualities” of the economic, industry, and specific company attributes that will provide for business success? If attained, their stock prices will follow.

1. The macroeconomic environment, while subpar in strength, is sufficient for well run companies to flourish. There is ample labor, capital, and productive capacity for the recovery to last for years, not months or quarters. There are no excesses that need to be corrected by government or Federal Reserve. This sustainability is positive for American businesses.
2. There exists in the US today a significant underinvestment in infrastructure from transportation, to energy, to utilities to education. It is not a question of whether, but when these investments will be made. The result will be a return toward our historic 4% rate of GDP growth.
3. In the 1990's, there was a great deal of basic research done in both the physical and life sciences culminating in the Dot Com Boom/Bust. We are now in the midst of reaping the benefits through successful efforts in applied research with a plethora of medical, materials, and manufacturing innovations. The positive effects on our economy and well-being are just beginning to be felt.
4. On the corporate front, our businesses have built fortified balance sheets, maintained excellent returns on capital, and controlled their cost structures. They possess the business and financial flexibility to continue to prosper.

While continually on the alert, we take a very constructive view on the economy and stock market and feel that the positive “qualitative” factors will trump the “quantitative” concerns.



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The Growth Equity composite was created on January 1, 1993, representing actual separately managed taxable and tax-exempt equity client portfolios managed on a discretionary basis according to Princeton's Growth Equity investment strategy without client restrictions for the period(s) indicated.

Performance results are calculated internally using Advent portfolio accounting software. Accounts are included in each composite and its performance at the beginning of the first full calendar month in which the account is fully reflective of the investment strategy. Performance and index valuations and calculations include cash and cash equivalents and also include the reinvestment of dividends, interest and other earnings and are computed and stated in US dollars. All performance figures for periods one year and greater are annualized. Returns are weighted for the size of each underlying account. Net returns are reported net of management fees and commissions. A client's return will be reduced by our advisory fees and other expenses a client may incur in the management of the client's portfolio. Our advisory fees are disclosed in our Form ADV 2A. Also, there is a compounding effect of advisory fees over time on the value of a client's portfolio. As an example, the deduction of investment management fees would reduce the annualized return for the five years ended December 2013 from 21.2% to 20.0%. Actual investment advisory fees incurred by clients may vary.

The **S&P 500 Index** is an unmanaged index generally considered to be representative of the US stock market as a whole.

The **Russell 3000 Growth Index** is an unmanaged index that measures the performance of the broad growth segment of the US equity universe. These indices are unmanaged and include the reinvestment of dividends and earnings. Individuals cannot invest directly in any of these indices.

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