

Highly Focused in Turbulent Times

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ALEX BERNSTEIN: Hello, I'm Alex Bernstein and you're listening to The Alger Podcast, Investing in Growth and Change. Investors have faced a number of challenges this year, from the war in Ukraine to inflation churning and rising rates. For a focused portfolio manager, making decisions about a portfolio with a limited number of holdings in this kind of an economic market can be daunting. Here with me today to reflect on that idea, is Ed Minn, Portfolio Manager for Alger's most focused portfolio, the Alger Weatherbie Select 15 Strategy. Ed, thanks so much for joining me this afternoon.

ED MINN: Thanks, Alex.

ALEX: Ed, Select 15, as its name suggests, is a best ideas portfolio made up of only 15 smaller cap growth holdings. With such a limited number of holdings, I would guess that you need to act pretty strategically in this kind of market environment. Is that true?

ED: Yes, certainly. The advantage of Select 15 remains the same, and that is, I can take very sizeable, even double-digit percentage positions in highest-conviction ideas. But one challenge is that I have to part ways with some holdings that may be seeing continued healthy fundamentals, and have bright long-term futures, but for various reasons, maybe they're not profitable enough in the current environment which may be with us for the next couple of years, it's probably not one that would outperform. And so, in a typical portfolio I would trim that to a smaller, or some sort of below average position. But in this case, in Select 15, I would more likely than not have to part ways and replace it entirely, because it really is a portfolio of best ideas where you need high conviction on all of them.

I think it's tough to manage any portfolio with some of the macro factors affecting valuations so much. And we talk to our companies and stay close to our companies. I spent an hour and a half yesterday at the headquarters of one of our holdings. And broadly speaking, fundamentals are quite healthy, and yet in many cases the valuation has been reduced by 30 plus percent.

And so that's disappointing and frustrating, but when so much of the price action is macro driven, that's the price you pay for investing in equities, and you just have to stay focused on the long term and make sure you're owning the right companies.

ALEX: So, you never have an urge to go back to the team and say, "could I just have like a 16th holding? Or – could we kick it up to 18?"

ED: I feel very good about 15. It ensures that we stay focused on the most compelling 15. And it does offer enough room to have exposure to the parts of the market that are important to be in. For example, we believe energy is very important these days to have exposure to, given that those stocks zig while any time the rest of the market zags. And so, it does feel right to me.

ALEX: Ed, how have some of the recent market issues we seen, like labor shortages and energy concerns, impacted your holdings?

ED: First let me take a step back for a second and emphasize that while there's a lot going on on the macro front, we are bottom-up investors. We build a portfolio one stock at a time. And the criteria for identifying Weatherbie growth stocks are unchanged. It's very important to have a repeatable process that you can do over and over again for now more than 25 years for us. And so, with that backdrop in place, we have been putting incremental emphasis on companies with pricing power, meaning those that have the ability to raise prices and pass on cost inflation they're seeing either from employee wages or raw material inputs. We've been especially keen on insuring that our companies have the ability to hire the talent they need, to keep serving customers. We've been more sensitive to how companies will have to manage through high oil prices. And we've been finding some companies that actually benefit from elevated oil and natural gas prices. And of course, we've been more sensitive to companies with



exposure to Europe. Obviously Eastern Europe in particular, but frankly anywhere in Europe, because the odds of recession in Europe have increased quite a bit following the really sad developments in that area. So, in general, I would say, while we are of course unchanged in our investment process, we've been slightly more focused on higher quality, more predictable businesses. For example, those with higher margins. Certainly, less reliant on external funding to execute their business strategies. Those that are just, you could consider them foundation growth stocks, in the lingo that we use. So, one of the benefits of our investment strategy is that we tend to find so-called hidden gems, and by that I mean compelling investment ideas in otherwise mundane industries. So, we're not just finding companies in technology and health care sectors, where many of our peers are focused. And I think that philosophy pays extra dividends in this sort of environment, where near term profitability and quality are in extra high demand.

ALEX: Ed, I'd love to hear about a couple of holdings that you're particularly excited about.

ED: Sure. Well, there are quite a few names that I'm very excited about. One is an environmental services company, with expertise across a wide range of areas. It does measurement and analysis, helps conduct environmental studies. A very long list of services, very well diversified across those services. And this company, which is owned in Select 15 as well as Specialized Growth, has a track record of high single digit organic growth, which it then supplements with an active M&A program. Fairly small tuck-in acquisitions, which it can make at very attractive prices, really buying sort of mom-and-pop type businesses that most other acquirers wouldn't be interested in based on their small size.

But they fold in nicely to the business and, we believe, are fairly low risk and obviously supplement that with a very steady organic growth that this company has been putting up. And this is a company that grew much better than high single digits organically last year, even if you strip away some of the extra COVID related work that it did. And our analysis indicates that this company is well positioned to continue exceeding that historical organic growth rate well into the future. And one of the key reasons for that is just this major trend in the economy of companies as well as government organizations being a lot more focused on ESG related work, and those sorts of projects.

Even if they're not mandated by law, we believe just

about every public company out there wants to issue an ESG report and let all the stakeholders know how it's doing. And there's a lot of work that goes on to put those reports out. For example, carbon emissions. And that's not something a company will do in house. They'll hire an outside company like the one I'm speaking about to do that. And that's just one of a long list of services that are in white hot demand that this company provides. And so, we believe this company is well positioned for frankly any point in the market cycle, because these demand drivers should persist well into the future.

ALEX: Ed, I wanted to talk about innovation in context of that enduring Weatherbie theme you mentioned a minute ago: that of looking for gems in mundane areas. Have these mundane areas been sources of innovation for the portfolio?

ED: Well, I would say there's actually a fair amount of innovation within some of these mundane industries. For example, we own, and have owned for a long time, a waste management company that's focused on the Northeast, and it has a leading market share of about 20 percent of the landfill capacity in the Northeast U.S. And that puts the company in a special position, because there's a structural imbalance of growing waste volumes yet limited disposal capacity. And so pricing power is especially high for this company. As you might expect, this company employs truck drivers and folks involved with these recycling facilities and trash collection and so forth, and it's a very tight labor market for drivers as well as other folks who could get a good paying job at a distribution center of a large e-commerce company for example.

But we find that through one of the six criteria that we look for is high quality management team. And many management teams that are high quality have been investing in innovation like automation technologies ahead of the crisis and the super tight labor markets that we find ourselves in. We believe they care about their employees and have been investing in initiatives that promote diversity and reinforce the satisfaction, or appreciation of employees, and generally have these initiatives that promote a healthy culture, which allows them to attract and retain talent better than many of their peers.

One initiative that this company is doing is using software to optimize the routes that all of these trucks do in their trash collection activities. And it's amazing how much low hanging fruit, so to speak, is out there in applying software to these age-old problems.

ALEX: And as you mentioned, I know you and the Weatherbie team recently went through some significant ESG – or environmental, social and governance – training. Did this ESG lens at all reframe how you view the waste management company?

ED: Yes. The ESG training just sharpens the whole appreciation for carbon emissions and the whole supply chain that's contributing positively or negatively to supply chain emissions and the importance of renewable natural gas, RNG, and some really potentially important opportunities that are not fully tapped by some of the companies out there. And so, we think this company in particular comes out as even more attractive, now that we have an even deeper understanding of ESG.

ALEX: Why is that?

ED: Well, this company has a very significant impact on reducing or improving the carbon footprint of the customers that it works with. And its assets could be even better utilized over time for biogas renewable natural gas, as an example. And this company has a recycling business that we believe will grow in prominence, and some consulting capabilities for

recycling which should also see excellent demand in the years ahead.

ALEX: Ed, any final takeaway for investors?

ED: My number one message would be to stay the course, because while the macro goes up and down and sentiment goes up and down, ultimately the company's fundamentals or earnings capability are what will dictate its value. And we've been applying our investment approach for multiple decades with success and that gives me confidence that we'll continue to own and identify compelling, high-quality growth companies that may reward investors over the long run.

ALEX: Ed, thanks so much for talking with me this afternoon.

ED: Thanks Alex, great talking to you.

ALEX: And thank you for listening. For more information on Alger Select 15, and for more of our latest insights, please visit www.alger.com.

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