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Investment perspectives

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Portfolio Manager

Key highlights:

- The **First Investors Select Growth Fund** focuses on companies that can produce earnings faster than the market expects.
- A strong sell discipline surrounds the team's investment process.
- The team doesn't expect a recession in the near term and maintain a stable-to-positive earnings outlook for companies

Finding unexpected growth

We recently sat down with John Brim, Portfolio Manager, from the **First Investors Select Growth Fund's** subadvisor, Smith Asset Management Group (Smith Group), for an update on the Fund and their latest market outlook.

What do you look for in a company when considering making an investment in it?

Simply put, we are searching for companies that can grow earnings faster than expected by the market. If the market has earnings expectations of 10%, we are looking for a firm that can deliver more than that. *Exhibit 1* illustrates the growth differential between the **First Investors Select Growth Fund** and its benchmark, the Russell 1000 Growth Index. The Fund produced a substantial realized earnings growth premium of more than 300 basis points for the period, which lies at the core of its investment process.

Exhibit 1: Expected and realized growth

	Expected growth	Realized growth	Difference
First Investors Select Growth Fund	12.5%	17.0%	**+4.5%**
Russell 1000 Growth Index	11.2%	12.6%	+1.4%

Source: Smith Asset Management Group. This is the 10-year average of the last rolling 12-month 10-year periods. From 4/1/2009 to 3/31/2019. Thomson Reuters Corp. All rights reserved.

Can you describe your team's investment process?

As shown in *Exhibit 2*, our team begins by ranking all companies within our investment universe across a number of quantitative metrics such as the growth outlook for the particular firm and its earnings quality (see *Exhibit 3*). We then consider each company on a fundamental level. Based on that review, we construct a portfolio of companies that we expect to produce better-than-market-expected earnings. Embedded in our overall approach is a strong sell discipline that is triggered when fund holdings achieve their targeted valuations, or when there is a deterioration in earnings quality or growth potential.

Exhibit 2: Investment process

1) **Quantitative ranking** – systematic organization of company fundamentals; then rank these companies in various categories (growth outlook, earnings quality, valuation); companies with high potential identified
2) **Fundamental review** *(i.e., what is causing the high rank for a company?)*
3) **Portfolio construction** *(building a diversified portfolio of companies with high rank)*
4) **Sell discipline**

Source: Smith Asset Management Group.

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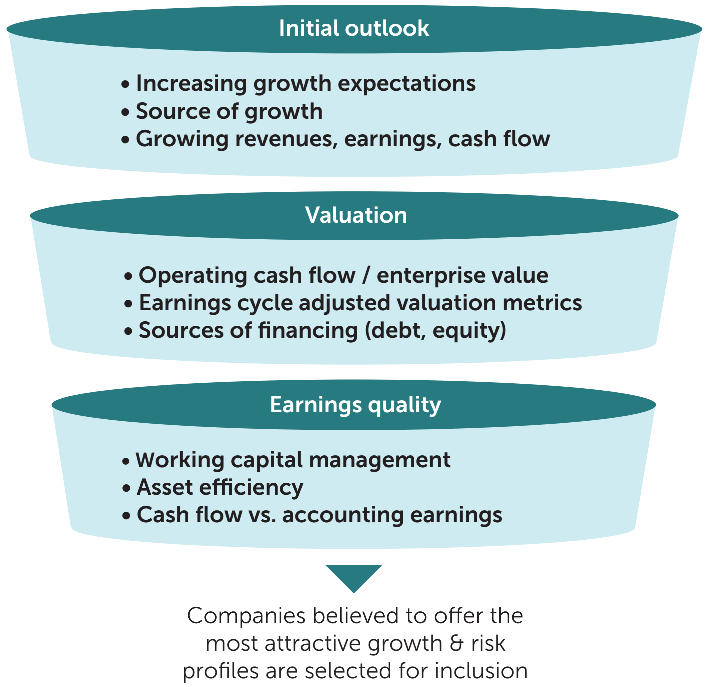
Exhibit 3: Quantitative screening process



Source: Smith Asset Management Group.

How long does the Fund hold a stock?

The typical holding period for a stock in the Fund is about two years.

Can you give us an example of one of your purchases?

We looked at a large grocery chain that was not a traditional growth company but still appeared on our screens as highly ranked based on various criteria. Its industry was facing a wave of consolidation and this company was adding to its store base. In addition, as a part of its new strategy, each store was introducing more high-end products such as organic produce and prepared foods. These types of goods tend to offer higher margins, which could lead to higher earnings growth for this grocer. In our opinion, as a Consumer Staples company it was very attractively priced and we thought it could easily meet the market's expectation. So, the higher growth rate it achieved led to higher earnings. Our investment framework, by identifying companies through isolating key metrics, produced an opportunity to investment in a firm that was not well understood by market.

Is there another example of your process in action you can share?

Yes. We had a particular holding that we sold earlier this year. A home improvement store chain had deployed a new point-of-sale technology strategy that saw its inventory management improve significantly. This, in turn, reduced the working capital requirement for the company. They then rolled out their "prime time" strategy. This concept was based on the observation that most of their customers would visit the store during their lunch hour for a specific item. The new approach was centered on the idea that store staff needed to be visible on the floor at that specific time. That led to improved customer service experience, which produced greatly improved earnings. In the first quarter of 2019, the company saw sluggish sales and had growth expectations of approximately 9%. We noticed that their inventory levels started creeping up, which suggested to us that our investment thesis was ending. That triggered our sell discipline so we exited our position in the company.

What is your team's economic outlook?

Entering 2019, we expected the Federal Reserve to remain on hold for the year and not make any interest rate moves. From our perspective, the Fed is fulfilling its twin mandate of ensuring stable prices as there really is no meaningful inflation at this time and employment has continued to be strong this year. We also would mention that during the recent earnings season, on calls with CEOs, two-thirds of them mentioned tariffs so clearly U.S.-China trade policy is resonating across the country. Having said that, we don't expect a recession in the near term and we maintain a stable-to-positive earnings outlook for companies.

Did the change in the Fund's benchmark impact the portfolio in any significant way?

When the Fund shifted to the Russell 1000 Growth Index from the Russell 3000 Growth Index, there was no resulting impact to our process or the Fund's positioning. The pool of possible stocks remained the same, despite the change.

Give us the quick elevator pitch for this Fund.

Smith Group is a different kind of growth manager. Since we believe that companies that produce higher-than-expected earnings will outperform the market over time, we are able to build a well-diversified portfolio with many holdings not typically held by other growth managers. The holdings usually exhibit solid growth with strong earnings quality, while still reasonably valued, and span across all sectors and a variety of market caps.This Fund offers investors an all-weather portfolio with a unique focus on unexpected growth rates for companies.

The **Russell 1000 Growth Index** measures the performance of the large- capitalization growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Index is a subset of the Russell 3000® Index, representing approximately 90% of the total market capitalization of that Index.

The **Russell 3000 Growth Index** measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 3000 Index is an unmanaged index that measures the performance of the 3000 largest U.S. companies based on total market capitalizations.

Price/earnings (P/E) is the price of a stock divided by its earnings per share. Sometimes called the multiple, P/E gives investors an idea of how much they are paying for a company's earning power. The higher the P/E, the more investors are paying, and therefore the more earnings growth they are expecting.

Investors cannot invest directly in an index. Indexes are unmanaged and do not reflect the performance of any particular security.

These views represent the opinions of the Portfolio Management Team and are not intended as investment advice or to predict or depict the performance of any investment. These views are as of the close of business on June 30, 3019, based on the information available at the time and are subject to change at any time based on market or other conditions. We disclaim any responsibility to update such views.

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