



# Broadleaf Partners, LLC

Growth Equity Portfolio  
Second Quarter Review  
June 30, 2014

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## Performance Commentary

	<u>Q2 2014</u>	<u>One Year</u>	<u>3 Years</u> <u>(Annualized)</u>	<u>5 Years</u> <u>(Annualized)</u>	<u>Since</u> <u>Inception</u> <u>(Annualized)</u>
<b>Broadleaf</b>	<b>3.5%</b>	<b>25.0%</b>	<b>13.3%</b>	<b>17.1%</b>	<b>8.4%</b>
S&P 500	5.2%	24.6%	16.6%	18.8%	7.8%

In absolute terms, our portfolio enjoyed a solid second quarter and while we recaptured some of the lost ground inflicted on high growth stocks towards the end of the first quarter, we continue to have work to do in catching the S&P 500's 7.1% year to date gain.

Our goal is to outperform our primary benchmark over a full market cycle, which has typically meant five or more years. While we have achieved this objective on a long term, net of fees basis, it has proven a more difficult feat in recent periods given the prolonged, stop and start nature of the recovery. The current economic cycle has not been typical.

While Fed policy has held unusual sway over the markets in recent years, over the long run earnings matter most to the direction and level of the stock market. For our thoughts on the portfolio and where we believe we head from here, please read our Market Review & Outlook.

*(Fund Inception 8/18/05. Portfolio performance reflects Broadleaf's Growth Equity Composite, described more fully under the caption "Performance Disclosures." You are urged to read that information in its entirety in connection with any evaluation of Broadleaf's performance statistics. All figures are shown net of actual fees. Any assumed fees have been calculated on a pro forma basis, reflecting the highest fee levels that Broadleaf would charge clients per our disclosures in Part II of our Form ADV.)*

## Market Review & Outlook

While the overall stock market's gains have been excellent this year, the correction that affected growth stocks towards the end of the first quarter continued through most of April. Fortunately, many high growth stocks started to turn the quarter at that time and are hopefully poised to continue their relative gains in the coming months.

What caused the turn in sentiment? While it is anyone's guess, we believe that the downturn was likely caused by uncertainty surrounding Fed policy following Janet Yellen's first press conference in March. In addition, the first quarter GDP readings have been absolutely horrendous, with the most recent revisions showing a -2.7% Q/Q decline.

While the Fed and most other economists believe the Q1 weakness was almost entirely weather related, the idea that they would verbally contemplate tightening moves in the face of such apparent readings probably spooked the markets, with the more highly valued areas getting hit the hardest. Fortunately, second quarter earnings commentary and leading indicators of the economy have supported the notion that nearly all of the Q1 weakness was weather related. In the most recent Fed press conference, policy didn't change - rate increases are likely a year off and remain data dependent – but the outlook for the economy in the second quarter has certainly shown a nice rebound.

Geopolitical events (Ukraine, Iraq, Russia), Fed policy moves, and the prolonged nature of the recent economic cycle have all contributed to the risk on/risk off nature of the stock market in recent years. While Fed rate increases may have an impact on stock prices in the short run – [see our piece on 1994](#) - long term evidence strongly supports the notion that earnings matter most to the direction and level of the stock market over the long haul.

Earnings season for the second quarter recently came to a close and for the Broadleaf Growth Equity Portfolio, the news was even better than it was in the first quarter. Our portfolio holdings grew revenues an average of 24% year over year in the second quarter compared to 21% for the first, driving 44% year over year gains in earnings compared to 27% in the prior period. Valuations do not appear excessive to us, with the portfolio sporting an average forward P/E ratio of 19x and a free cash flow yield of 3%.

All managers and investment styles ebb and flow from quarter to quarter, with most experiencing relative periods of weakness from time to time. As long as you believe in our long term investment process, periods like today are often the best – although not easiest - time to become a Broadleaf client.

[Our 2014 Playbook](#) remains intact, with early year weakness associated with Fed policy concerns followed by a more solid second half marked by clearer signs of economic growth and expansion. While overseas economies will likely remain punk, their weakness should help to keep domestic inflation restrained in a more moderate nominal growth environment. Historically speaking, such periods have been among the very best for equity market investors.

### **Portfolio Characteristics**

#### **Top Five Portfolio Holdings**

Apple  
Facebook  
Schlumberger  
Gilead Sciences  
Amazon

<b>Sector Concentrations</b>		
	<u>Broadleaf</u>	<u>S&amp;P 500</u>
Technology	27.0%	18.8%
Cons. Disc.	24.6	11.9
Industrials	17.4	10.5
Healthcare	14.0	13.3
Financials	7.6	16.1
Energy	5.0	10.9
Cons. Staples	0.0	9.5
Utilities/Tel	0.0	5.5
Materials	0.0	3.5
Cash	4.4	

<b>Portfolio Statistics</b>	
Avg. Market Cap.	\$81.5B
Median Market Cap	\$29.7B
Forward P/E Ratio	19.1x
Free Cash Flow Yield	3.1%
Consensus Growth Rate	19.8%
Return on Equity	21.4%
Beta	1.00
Portfolio Yield	0.7%

### **Investment Style**

The Broadleaf Growth Equity Portfolio employs a concentrated growth style of investing, holding approximately thirty equity positions from a cross section of economic sectors. Morningstar would classify us as a large cap growth manager, but we will invest in select small and midsize companies as unique opportunities avail themselves. Currently, the portfolio has an average market capitalization of \$81.5 billion.

Sector exposures are strongly influenced by our views on three determinants of investment value, which we define as the economic cycle, the innovation cycle, and the credit cycle. Individual securities are ultimately selected on the basis of their long term growth potential, profitability, and intrinsic value as measured by their free cash flow generating characteristics. Innovative new ideas and themes are of particular interest.

### **Investment Objective**

The portfolio's goal is to outperform the S&P 500 index over a three to five-year time horizon or full market cycle. The portfolio is suitable for investors seeking an exposure to a concentrated investment style which may be more volatile than the market as a whole. Investors should consider it as a portion of their investment portfolio within the context of their overall asset allocation and related investment goals.

### **Performance Disclosures**

*Results reflect the actual performance of Broadleaf's Growth Equity Composite. Performance data is shown net of advisory fees and trading costs. Broadleaf may charge different advisory fees to clients based on several factors, but primarily based on the size of a client's account. Broadleaf's basic fee schedule is available on its Form ADV, Part II. Results reflect the reinvestment of dividends and distributions, if any. Leverage has not been utilized. The U.S. Dollar is the currency used to express performance.*

*Broadleaf's Growth Equity Composite includes all fully discretionary accounts utilizing our growth equity style of investing with a minimum initial account size of \$250,000. (From firm inception to 6/30/2009 our minimum account size for composite inclusion was \$250,000 and from 6/30/2009 to 6/30/2013, the minimum was \$100,000. Historical results have not been updated retroactively to reflect changes in account minimums, but are reflected on a going forward basis.) To be included in the composite, an account must have been under management for at least one full quarter. If a significant cash flow in an underlying composite account during the quarter causes it to deviate from our intended growth style, we will remove the account for the period in which the significant cash event occurred. A significant cash flow is currently defined as 10% or more.*

*Total firm assets at quarter end were \$169.9 million. Prior to January 5<sup>th</sup>, 2006 the firm did not have any investment advisory clients. As a result, composite data prior to March 31<sup>st</sup>, 2006 only reflects the performance of Doug MacKay's personal retirement account.*

*The S&P 500 Index has been used for comparative benchmark purposes because the goal of the stated strategy is to provide equity-like returns. The S&P 500 is a broad based index reflecting the performance of the equity market in general. The index is based on total returns which includes dividends. While we believe this is an appropriate benchmark to use for comparison purposes, it should be expected that the volatility of the Broadleaf Growth Equity Portfolio may be higher due to its concentrated nature.*

*Performance information since inception reflects actual performance of the composite over a period of greater than five years. You are cautioned that information concerning comparative performance over this period of time may bear no relationship whatsoever to performance over other time periods. This information should not be regarded as in anyway representing the likely future performance of the portfolio in absolute terms or in comparison to the indices. Investment in securities, including mutual funds, involves risk of loss. Past performance is no guarantee of future returns.*

*Broadleaf Partners, LLC is a registered investment advisor with the Securities and Exchange Commission. The firm maintains a complete list and description of composites, which is available upon request.*

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