

Focus Equity SMA Commentary

1st Quarter 2024

Quarterly Review

Performance	QTR	YTD	1YR	3YR	5YR	Since Inception ¹
Sterling (Gross)	8.16%	8.16%	35.32%	6.97%	14.16%	16.66%
Sterling (Net)	7.38%	7.38%	31.46%	3.86%	10.86%	13.29%
Russell 1000 [®] Growth Index	11.41%	11.41%	39.00%	12.50%	18.52%	17.29%

Performance and Market Update

In the wake of 2023 results that surpassed *every* U.S. Russell index style box and *all* major international equity benchmarks, the Focus Equity strategy continued to rise in 1Q24, advancing +8.16% gross, +7.38% net of fees. Cumulatively through 1Q24, the strategy's annualized results (+16.66% gross, +13.29% net of fees) have grown the value of an initial investment since inception by more than 2.5x.²

Technology sector returns and growth style returns were strong in the period.³ Markets advanced in Q1 despite rising Treasury yields and a "no landing" scenario for the U.S. economy, with high growth and persistent inflation, was priced into the interest rate curve.⁴ The Russell 1000[®] Growth Index (R1000G) rose +11.41% in 1Q24. Just one stock, Nvidia, accounted for >125% of the Q1 gross and >118% net performance difference between the Focus Equity strategy and the R1000G. In February, that company's market capitalization added Wall Street's largest one-day gain in history and accounted for >35% of the R1000G's *entire* index gain during the quarter, helping extend the run for the "Magnificent Seven".⁵ Our previous Focus Equity commentaries highlighted the strategy's differentiated portfolio positioning versus increasing U.S. market index concentration, which finished Q1 at its highest level since 1966.⁶ We believe our portfolio roster remains well positioned for the long term.

¹Inception date is 12.31.2015. Data is as of 03.31.2024. The benchmark is the Russell 1000 Growth. Effective 06.30.2023, the net of fee performance reflects the deduction of the maximum SMA bundled fee of 3.00% annually for all periods presented. Performance is preliminary and is annualized for periods longer than one year. Net of fees performance returns are presented net of the SMA bundled fee, which includes all charges for trading costs, advisory services, portfolio management, custody and other administrative fees. "Pure" Gross of fees performance returns do not reflect the deduction of any fees including trading costs: a client's return will be reduced by the management fees and other expenses it may incur. Investment management fees are described in Sterling's Form ADV 2A. Performance reflects the reinvestment of interest income and dividends and realized capital gains. The performance presented represents past performance and is no guarantee of future results. Performance is compared to an index: however, the volatility of an index varies greatly and investments cannot be made directly in an index. Market conditions vary from year to year and can result in a decline in market value due to material market or economic conditions. Please refer to the attached GIPS Composite Report for additional disclosures. Sources: Russell Investments; eVestment Alliance; Sterling Capital Management Analytics.

²Sterling Capital Management Analytics.

³Strategas; Sterling Capital Management Analytics.

⁴Business Insider.

⁵Reuters. The "Magnificent 7" refers to a group of high-performing U.S. stocks in the S&P 500 Index comprised of Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla.

⁶Financial Times.



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Throughout the quarter, we continued to execute our investment discipline. Our ongoing diligence recently included a variety of management meetings and, based on our research, we can summarize our view that fundamental conditions continue to improve. The expense optimizations witnessed in 2022 and 2023, for example, were pared back in early 2024 as management teams appeared to focus more squarely on revenue growth.^{7,8} While the U.S. Federal Reserve (Fed) rate policy turns less restrictive, we believe Focus Equity companies stand ready to capitalize on the emerging economic growth cycle.^{9,10}

1Q24 Attribution

Leading Contributors	Portfolio Weight	Gross Contribution to Return	Net Contribution to Return
Adyen N.V. Un-sponsored ADR	15.86	4.34	4.22
Amazon.com, Inc.	5.55	1.00	0.96
Veeva Systems Inc Class A	4.10	0.80	0.77
Microsoft Corporation	6.35	0.79	0.74
CoStar Group, Inc.	6.88	0.69	0.63

Sources: FactSet; Sterling Capital Management Analytics.

Adyen's share price continued to rebound, which we believe was driven by strong results displaying double-digit growth across all key business metrics: processed volume (+29%); net revenue (+23%); and earnings before interest, taxes, depreciation, and amortization (EBITDA) (+14%).¹¹ We see volumes steadily ramping from meaningful platform partnerships like Block's Cash App, where the user base and payment volume has *tripled* in the past five years.¹² Meanwhile, Adyen is extending the breadth of other relationships such as Adobe Commerce, which we think enlarges Adyen's footprint of global enterprise merchant customers.¹³ We think the company is taking appropriate strategic steps to commit itself to long-term growth as evidenced by Adyen's recent commitment to establish a San Francisco headquarters in the U.S., the largest global payments market outside China.^{14,15}

Operating margins at **Amazon** were *over four times* higher than last year, and free cash flows (FCF) positively inflected by *>\$50B* as CEO Andy Jassy prioritized profit improvement over growth in 2023.¹⁶ Meanwhile, driven by new TV content partnerships, advertising segment revenues grew +27% year-over-year (y/y) to set a new all-time record. We think this segment's performance, combined with a re-acceleration in Amazon Web Services segment revenues, may continue to enhance longer-term profitability since its higher margins (versus Retail) are accretive to bottom line results.¹⁷

⁷Tech Crunch.

⁸The Wall Street Journal.

⁹The Federal Reserve.

¹⁰Reuters.

¹¹Adyen Company Reports.

¹²Cash App Company Data; Business Insider.

^{13, 14}Adyen Company Reports.

¹⁵Statista Market Insights.

¹⁶Amazon Company Reports.

¹⁷Adexchanger.

Please refer to the Performance Disclosure found on page 9.



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Veeva grew revenues +12% y/y, guided cash flows to +28% growth, and closed two more top-20 pharma customers on its new data platform.^{18,19} Management also flagged several wins in Regulatory and Quality product suites. We view these developments as additional signposts on Veeva's road towards market leadership in clinical data management. We remain watchful for upcoming customer migrations to the company's new Vault Customer Relationship Management (CRM) Suite and broader adoption of the recently introduced Data Cloud, an offering we believe could modernize reference and transactional data to enhance insights for pharma customers.²⁰

We believe artificial intelligence (AI) adoption continues to drive rapid +28% y/y revenue growth for **Microsoft's** Azure cloud platform, helped by the company's unique commercial partnership with OpenAI.²¹ Importantly, the company has not sacrificed profitability for growth, as operating margins remain >43%. We also found recent sales pipeline color helpful, as an increase in larger (>\$1B commitments) strategic deals is bolstering backlog statistics.

Despite the weak backdrop for commercial real estate markets, **Costar** reported +12% revenue growth led by Apartments.com (+23%), along with consistent expansion of the core Costar product suite.²² CFO Scott Wheeler (who announced his planned retirement in June) articulated a step-up in investment for the company's new residential platform, Homes.com, which is expected to subdue EBITDA growth in the near term. However, we see the strategic logic of this spending as sound, not just due to management's previous success executing a similar playbook while scaling Apartments.com, but also due to the traction with agent sign-ups and brand visibility created by the Homes.com media blitz during the Super Bowl.²³ We also believe recent changes to the agent compensation model, stemming from the National Association of Realtors settlement in March, may favor Costar's seller-first "your listing, your lead" sales approach.^{24,25} We feel that Costar's strategy differs from market incumbents that have historically monetized buyer agent commissions, now challenged by the settlement terms.²⁶

Leading Detractors	Portfolio Weight	Gross Contribution to Return	Net Contribution to Return
Atlassian Corp Class A	4.64	-0.85	-0.88
Unity Software, Inc.	1.29	-0.78	-0.79
S&P Global, Inc.	8.09	-0.23	-0.30
MongoDB, Inc. Class A	1.02	-0.23	-0.24
IDEXX Laboratories, Inc.	6.00	-0.16	-0.20

Sources: FactSet; Sterling Capital Management Analytics.

Atlassian reported +22% revenue growth but slightly lowered core cloud guidance as, in our opinion, the ongoing customer transition away from perpetual licenses proceeds along a bumpy yet positive trend.²⁷ Importantly, customers spending >\$10K grew +18%, suggesting that Atlassian's installed base continues to expand, transitioning customers are staying within the Atlassian ecosystem, and users are migrating at higher rates than expected through the Data Center deployment while staying on a long-term path to Cloud.

^{18,19,20}Veeva Company Reports.

²¹Microsoft Company Reports.

²²Costar Company Reports.

²³Design Rush.

²⁴National Association of Realtors.

²⁵Real Estate News.

²⁶U.S. Securities and Exchange Commission.

²⁷Atlassian Company Reports.

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We discuss **Unity** and **MongoDB** in the *Portfolio Changes and Diligence Updates*.

S&P Global grew revenues +10% but issued conservative 2024 guidance that we believe is appropriate given the CFO leadership transition currently underway.^{28,29} Beyond past personnel changes, our diligence suggests underlying business drivers, such as billed issuance, remain strong heading into the 1Q24 results.^{30,31} In our view, S&P Global remains a leader in mission-critical data and analytics offerings, and we are excited to see management move past the IHS Markit merger integration to focus more acutely on growth execution in 2024.

We met with **IDEXX** management during Q1 to gather insights on business trends and to better understand the growth opportunity created by its recently introduced Invue in-clinic analyzer.³² Management believes Invue could offer >20K instrument placement potential and, in our opinion, has conservatively guided financial expectations for 2024.³³ We think new analyzer (“razor”) placements may positively reinforce the “razor and blade” recurring revenue model, since this countertop equipment drives more consumable test (“blade”) volume from vet clinic customers over the long term. Companion animal diagnostics continue to grow at a double-digit pace, which we view as sustainable, amid choppy (but improving) market demand trends.³⁴

Portfolio Changes and Diligence Updates

Focus Equity added a new position in **MongoDB** (MDB). We consider MDB a leader in the large and fast-growing database management software (DBMS) market, which sector specialists size at >\$90B and expect to expand at a double-digit annualized rate through 2027.³⁵ The DBMS market can be bifurcated into traditional relational databases and newer non-relational databases.³⁶ Relational databases represent over 75% share currently, but are only growing by mid-single digit rates.³⁷ By contrast, the non-relational market is growing more than twice as fast and is expected to take >25% share of the market by 2027. Over 96% of MongoDB’s revenue flows from software subscriptions, the majority of which is Atlas (63%), the company’s cloud database-as-a-service offering and fastest-growing solution (+47% y/y).³⁸ We think Atlas’ rapid growth is consistent with broader industry trends, since cloud deployments drove >95% of the DBMS market’s growth in recent years.³⁹ The company’s other subscription revenues flow from its Enterprise Advanced solution, including on-premises and hybrid server licenses representing 29% of total revenue growing +20% in fiscal year 2023. The company currently generates 75% gross margins and low single-digit adjusted operating margins with plans to improve to over 20% in the long term.⁴⁰

^{28,29,30,31}S&P Global Company Reports

^{32,33,34}IDEXX Company Reports.

³⁵Gartner Research.

³⁶Amazon Company Reports.

³⁷Gartner Research.

³⁸MongoDB Company Reports.

³⁹Gartner Research.

⁴⁰MongoDB Company Reports.

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MDB management's growth strategy focuses on acquiring new customers and workloads, expanding usage and spend within existing customers, releasing new product capabilities like Atlas Search and Stream Processing, and converting its large base of free Community Server users to paid versions. We think MDB has hit important growth milestones as it serves over 45K customers, including 35% of the Global 2000,⁴¹ reflecting customer momentum. Moreover, their net annualized recurring revenue expansion rate remains above 120%, which we think demonstrates MDB's ability to drive increasing spend from its existing customer base.⁴² We also believe the company may benefit from strong generative AI demand trends since its solutions help developers more efficiently streamline AI-enriched applications.⁴³

We also added a new position in **Saia** (SAIA), which operates in the \$50B less-than-truckload (LTL) freight industry, providing transportation, logistics, and supply chain services. We have closely tracked the LTL industry for many years, due in part to Focus Equity's longstanding ownership of **Old Dominion**, a Saia peer. LTL involves shipping relatively small loads (>100 lbs) on more logistically complex routes versus a full truckload, which we think enables LTL providers to establish competitive differentiation of quality of service and customization of rates.⁴⁴ Among the few industry participants that have materially grown their warehouse footprint over the past decade, Saia has consistently gained market share to become the eighth-largest U.S. LTL carrier by revenue.^{45,46} We think the business could be positioned to accelerate growth via both organic expansion into new regions (i.e., Northeast) and inorganic terminal acquisitions from the Yellow Corporation bankruptcy sale.⁴⁷

In addition, we see continued improvement in Saia's quality of service, which industry research consultants rank among the top three national carriers.⁴⁸ In our view, service quality is a precondition for pricing leverage, and Saia's ability to increase margins (from rate increases) may follow customer value enhancements (from service quality improvements), a strategy we have observed Old Dominion execute well for many years.⁴⁹ Saia's management team continues its focus on steady service improvements and market share gains, which have generated financial results, including more than *tripling* earnings per share (EPS) over the past five years. We see fundamental tailwinds strengthening, fueling Saia's ability to surpass more milestones on the road ahead.

⁴¹The Global 2000 ranks the largest companies in the world using four metrics: sales, profits, assets, and market value.

^{42,43}MongoDB Company Reports.

⁴⁴Coyote Logistics.

⁴⁵Saia Company Reports.

⁴⁶Old Dominion Company Reports.

⁴⁷Saia Company Reports.

⁴⁸Mastio Company Reports.

⁴⁹Old Dominion Company Reports.

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Focus Equity exited its longstanding position in **Unity Software** (U) and recycled sale proceeds to fund the new additions above. Within the large and attractive market for gaming entertainment, we still think Unity's game development platform remains a formidable asset, evidenced by 69% of the top 1,000 mobile games that were created with Unity's tools.⁵⁰ However, in our opinion, development of the profit model (particularly in digital advertising) recently suffered as management execution mishaps delayed realization of our assumed long-term operation margin potential. Although we credit the board of directors for taking decisive steps to transition the interim CEO role to company veteran Jim Whitehurst, as well as supporting his streamlining the operating segments to better focus the growth strategy, we acknowledge the company remains in turnaround mode and likely needs more time to rebuild momentum.^{51,52} During our deeper diligence of the industry, we observed stronger-performing peers taking market share from Unity, putting additional pressure on the urgency of the company's turnaround.⁵³

We also exited our position in **Casella Waste Systems** (CWST), instead recycling capital to fund new positions. We still regard Casella's founder-led culture as differentiated among the industry and acknowledge the regional expansion opportunities afforded by recent acquisitions in the Mid-Atlantic region.⁵⁴ Our site visits last year helped cement our view that CEO John Casella and his team continue to invest in efficient growth. However, as detailed in the paragraphs above, we see fundamental inflection points for MDB and SAIA and seek to concentrate our portfolio roster with the companies and management teams that we believe may benefit most from both secular and cyclical business tailwinds.

Outlook

The first quarter witnessed a steady rise in equity markets as the Fed's progress tackling inflation fueled investor relief, in our opinion. However, we remain skeptical of any straight trendlines and instead assume a bumpier path towards achievement of price stability. Recent figures illustrating a "still warm" inflation picture inform our stance. Nonetheless, we believe a Fed policy endgame of a "no landing" macro scenario is increasingly plausible. We further contend that steady economic growth conditions could facilitate a broadening of stock leadership as cyclical factors play a larger role in market returns. Several observations suggest this market dynamic has already begun.^{55,56} We view increasing market breadth as a potential tailwind for Focus Equity since our portfolio construction has long been concentrated outside the largest mega-cap names.

^{50,51,52}Unity Company Reports.

⁵³AppLovin Company Reports.

⁵⁴Casella Company Reports.

⁵⁵Yahoo! Finance.

⁵⁶Morningstar.

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We retain cautious respect for near-term challenges including ongoing conflicts in Ukraine, Israel, and Taiwan that keep geopolitical risks on front pages worldwide. We also acknowledge our country is quickly approaching a U.S. presidential election which historically has increased market volatility.⁵⁷ Yet, using our farsighted lens, we maintain abiding optimism as we believe Focus Equity remains well positioned for the long term. One proof statement informing our view is Russell Index performance data over the past decade that shows Large Growth compounding annually at a mid-teens rate, outpacing Large Value by over 75% and Small Growth and Value by approximately 2:1.⁵⁸ Large Growth displayed resilience through the COVID-19 crisis and outperformed every combination of size and style both since the market's pre-pandemic peak and since its pandemic low. Those figures help validate our view that, despite macro fog, Focus Equity is positioned within an attractive and durable market segment over the long term. Our journey continues.

We'll close with a reminder that we continue to value ownership mindsets. To that end, it's important to reemphasize that Focus Equity remains your portfolio manager's largest family investment. Put simply, we eat our own cooking and are strongly incentivized to continuously protect and grow your Focus Equity investment.

Just below the text of this letter, you will find Focus Equity's quarter-end position list. The strategy remains concentrated in 21 active positions with 44% of assets in the top five, 68% in the top 10, and 86% in the top 15 positions. We have relatively few eggs but watch our basket closely.

Thanks for your trust and investment in us.

Colin Ducharme

Colin Ducharme, CFA®
Portfolio Manager

⁵⁷J.P. Morgan.

⁵⁸J.P. Morgan Asset Management.

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March 31 2024 Positions⁵⁹

Adyen	17.4%
S&P Global	7.6%
CoStar	6.9%
Microsoft	6.3%
Amazon	5.8%
IDEXX	5.7%
Hubspot	4.9%
ServiceNow	4.6%
Alphabet	4.5%
Shopify	4.2%
Veeva	4.2%
Atlassian	3.8%
Workday	3.8%
Okta	3.4%
Cadence	3.0%
Synopsys	2.9%
MSCI	2.6%
Old Dominion	2.4%
MongoDB	2.3%
Saia	1.8%
HEICO	1.0%
Cash	0.9%
Top 5 Total	44.0%
Top 10 Total	67.9%
Top 15 Total	86.1%
Top 20 Total	98.1%

⁵⁹Representative Account. Holdings note: The weightings for your account may differ somewhat from the figures above due to variations in account holdings, trade timing, and other client-specific circumstances. For illustrative purposes only. Specific securities identified and described do not represent all of the securities purchased, sold or recommended to clients. There are no assurances that securities identified will be profitable investments. The securities described are neither a recommendation nor a solicitation. Security information is being obtained from resources the firm believes to be accurate, but no warrant is made as to the accuracy or completeness of the information.



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Performance is compared to an index, however, the volatility of an index varies greatly. Indices are unmanaged and investments cannot be made directly in an index.

The Russell 1000[®] Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000[®] companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000[®] Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.

Technical Terms: **Earnings per share (EPS)** is calculated as a company’s profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company’s profitability. It is common for a company to report EPS that is adjusted for extraordinary items and potential share dilution. **EBITDA**, or earnings before interest, taxes, depreciation, and amortization, is an alternate measure of profitability to net income. By stripping out the non-cash depreciation and amortization expense as well as taxes and debt costs dependent on the capital structure, EBITDA attempts to represent cash profit generated by the company’s operations. **Free cash flow (FCF)** represents the cash that a company generates after accounting for cash outflows to support operations and maintain its capital assets. Unlike earnings or net income, free cash flow is a measure of profitability that excludes the non-cash expenses of the income statement and includes spending on equipment and assets as well as changes in working capital from the balance sheet. (Technical definitions are sourced from Corporate Finance Institute.)

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Sterling Capital Focus Equity SMA

	Total "Pure" Gross Return	Total Net Return	Benchmark Return	3Y Composite Std. Dev. (Gross)	3Y Benchmark Std. Dev.	Composite Dispersion	Number of Portfolios	Composite Assets (MM)	Total Firm Assets (MM)
2023	44.12%	40.03%	42.68%	25.90%	20.51%	0.32%	80	\$27	\$66,746
2022	-33.73%	-35.74%	-29.14%	25.94%	23.47%	0.31%	104	\$25	\$62,842
2021	16.35%	12.99%	27.60%	20.02%	18.17%	0.36%	238	\$111	\$75,309
2020	36.48%	32.58%	38.49%	20.88%	19.64%	1.01%	251	\$104	\$70,108
2019	43.06%	39.00%	36.39%	13.72%	13.07%	0.67%	151	\$35	\$58,191
2018	4.19%	1.15%	-1.51%	13.77%	12.13%	Not Calculable	36	\$5	\$56,889
2017	29.91%	26.20%	30.21%	< 3 Years	< 3 Years	Not Calculable	5	\$1	\$55,908
2016	12.24%	8.99%	7.08%	< 3 Years	< 3 Years	Not Calculable	4	\$0	\$51,603

Benchmark: Russell 1000® Growth Index

Composite Creation Date: 08.03.2018

Inception Date: 01.01.2016

- Consists of all discretionary separately managed wrap Focus portfolios. SCM's Focus portfolio investments are flexible and may span growth and value, large- and small-capitalization companies, and various capital forms including equity, debt, and derivatives. The strategy seeks positions featuring sustainable, multi-year return profiles underpinned by businesses perceived to possess attractive financial returns, visible reinvestment opportunities, and talented management.
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- The performance presented represents past performance and is no guarantee of future results. Market and economic conditions vary from year to year and can result in a decline in market value due to material market or economic conditions. Please refer to the slide titled "Performance" for the one-, five-, and ten-year returns of the composite.
- A complete list of all of SCM's composites and SCM's broad distribution pooled funds and their descriptions is available upon request. Policies for valuing investments, calculating performance, and preparing GIPS Composite Reports are available upon request.
- Performance reflects reinvested interest income and dividends and realized and unrealized capital gains and losses. All portfolios utilize trade-date and accrued income accounting. Valuations and performance are reported in U.S. dollars. Periodic time weighted returns are geometrically linked. Returns are not calculated net of non-reclaimable withholding taxes due to immaterial dollar amounts. Effective 9/1/18 composite returns are asset weighted using the beginning market value and time weighted return of the portfolios. Prior to 9/1/18, composite returns were asset weighted using the aggregate method that reflects both beginning market value and cash flows.
- "Pure" gross of fees returns are presented as supplemental information and do not reflect the deduction of any fees including trading costs. Net returns are calculated by deducting the highest applicable wrap fee of 3.00% annually from the pure gross composite return. As of 6/30/23, the composite model fee was updated to 3.00% annually for all periods presented. Prior to this change, the net of fees returns reflected the maximum bundled external platform fee of 2.52%. From 9/1/18 through 12/31/20, the net of fees returns reflect actual SMA fee of the individual account. Prior to 8/31/18, gross of fees returns reflect the deduction of trading costs. Net returns were calculated by subtracting the applicable SMA fee (2.57% on an annual basis or 0.21% per month) on a monthly basis from the gross return. Effective 9/1/18, "pure" gross of fees returns do not reflect the deduction of any fees including trading costs. The SMA fee includes all charges for trading costs, portfolio management, custody, administrative fees, and foreign withholding taxes. The maximum SMA or bundled external platform fee is 2.52% annually and includes Sterling's actual management fee of 0.27%. Sterling's actual management fees are 27 basis points annually. From 12/31/15 to 8/31/18 the composite was comprised 100% of separate accounts. As of 9/1/18 the composite has been comprised 100% of wrap fee portfolios.
- Effective 1/1/22, portfolios are removed from the composite for flows 10% or greater of prior month portfolio market value. Portfolio remains out of the composite for the month of the flow and for one additional period. Prior to 1/1/22, portfolios were not removed from the composite for flows.
- Effective 3/31/20, the appropriate benchmark was changed retroactively to inception from the Russell 3000® Index to the Russell 1000® Growth Index. The Russell 1000® Growth Index measures the performance of the large cap growth segment of the U.S. equity universe. It includes those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values. The index is reconstituted annually. Total return includes price appreciation/depreciation and income as a percent of original investment.
- The annual composite dispersion presented is measured by an asset-weighted standard deviation calculation method of all portfolios in the composite for the entire year, and is calculated using gross of fee returns. It is not meaningful when there have been less than six portfolios in composite for entire calendar year. The three year annualized standard deviation measures the variability of the composite and benchmark returns over the preceding 36-month period. The composite 3-year standard deviation is calculated using gross of fee returns. It is not required to be presented when a full three years of composite performance is not yet available.