A Q&A with Brian Beitner, CFA

Managing Partner, Chautauqua Capital Management

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1. **While you've spent the last 11 years managing global portfolios at Chautauqua Capital Management, you began your career focused on US equities. Why did you migrate toward international investing?**

   My exposure to the Global markets dates back more than 30 years to my involvement with the international team at Scudder Stevens & Clark. In addition, we had to have a global understanding to evaluate many of the US multinational companies that we used at TCW. So while the investment process at Chautauqua has been consistently applied since 1987, frequently in a global context, its application to international portfolios began in 2006.

   Why international? First of all, worldwide investing offers an expanded opportunity set. Approximately 95% of the global population and about three-quarters of the world's economic activity (based on nominal GDP) occurs outside the United States. Second, given elevated growth rates in these non-US countries, active managers simply have more opportunity to find advantaged, high-quality growth investments—active management has had significant headwinds since the 2008 financial crisis, but we think active management continues to add value in the non-US markets. We believe a sound strategy around variables such as currency, country and sector allocation can give active managers, like us, great opportunity to diversify within a concentrated portfolio.

2. **What is unique about Chautauqua's team approach and how are decisions finalized in the portfolios?**

   It defies easy categorization. I'm the lead portfolio manager, but all six members of the portfolio management team are engaged in every element of our multi-step stock evaluation process. It's not until our seasoned generalists and I have thoroughly analyzed each company's business model advantage and have evaluated the geographic, currency and macro implications of its business, that we are satisfied the company meets our quality criteria that we actually assign the company to a team member for model construction. And for us, models are a group tool—we don't just use one analyst's projections. Once the model is complete, we stress test it and hash out projections for cash flow based on our combined understanding of the business and its industry.

   Any team member may propose a company for initial analysis and ideas generally spawn from discussions about trends and the listed results of screens. Through our process, most ideas die early and the multi-step, "all hands on deck" approach means the process itself is the decision maker. Names aren't added until everyone's concerns have been addressed. Even then a potential addition to the portfolio is compared on a profitability, growth and valuation-based score relative to what we already own. Those that don't score well enough typically are moved to the watch list.

   There are several benefits to our approach:
   1. We avoid the bias that results when analysts are incentivized to sell ideas to PMs.
   2. We avoid problems brought on by an industry/sector-specific analyst's lack of full market perspective.
   3. We don't place too much reliance on a single "all knowing" portfolio manager.
   4. We have better team harmony because, at the end of the year, we all share full responsibility for everything that happened in the portfolio.
   5. Continuity and succession risks go away when everyone is steeped in every holding and has mastery of the process.

   At the end of the process, the team's work drives the decision. I do not override the objections raised by team members throughout the process.

   Furthermore, our team is rightsized and capable, owing to the fact that we hold around 40 securities, have a long-time horizon and a 20% name turnover, suggesting 8 new names a year. With 6 investment team members we can develop a thorough understanding of the company and industry fundamentals while other strategies with 100 names and 100% turnover would have to trade 100 names through the portfolio each year, requiring a much larger, and arguably less effective, team.

3. **You manage concentrated, high-conviction portfolios with 25–35 names in the international fund and 35–45 names in the global. How do you make sure no one holding has a disproportionate effect?**

There are two components to our risk management approach. The primary responsibility lies with our focus, with respect to investment risk, on the probability of a negative outcome rather than interim volatility. We are willing to withstand price volatility for companies that meet Chautauqua's quality requirements as long as the companies' fundamentals remain intact. We emphasize cash flow as a valuation metric. Downside protection is aided by our careful business analysis, consideration of macro factors and currencies, forward-looking valuation, and an emphasis on quality.

From a portfolio perspective, we control portfolio risk on the following fronts:

- Initial purchases and subsequent conviction weightings, range from 1% to 6% based on our assessment of appreciation potential, adjusted by our estimation of its risk of disappointment. Companies with the highest risk-adjusted appreciation potential, based on discussions resulting from a proprietary multi-factor model, receive the highest weights.
- At the security level, no individual company accounts for more than 10% of the portfolio.
- Currency and country risk is managed through a detailed analysis of each holding's geographic footprint. Here we delineate, on a country by country basis, where the company is generating revenue. This helps us quickly assess exposures by country in response to exogenous macro shocks. We further evaluate the major countries where we have exposures based on detailed analysis of their economic momentum, demographics and trade sensitivity.
- Portfolios are geographically diverse by region but we also take into account the major economic drivers for each economy. That way we avoid the risk of too much exposure to say, commodity exporters, for example.
- Diversification is enhanced by allocating to sector groups within the portfolio. This enables us to limit any unintended risks associated with shifts in investor preference for certain sectors and yet not sacrifice Chautauqua's ability to populate the portfolio with their best ideas.
- No sector can comprise more than half the portfolio. Portfolios are diverse and typically have exposure to most sectors.

We closely monitor portfolios on a daily basis. Conviction-weighting reviews take place at least monthly; even more frequently when considering either the addition or removal of a holding or as market conditions warrant re-evaluation.

4. **You're a quality growth manager with a valuation discipline. What valuation factors are critical to your stock selection process and how are they applied? Can you describe the firm's process for valuing securities?**

Our valuation work is the last step in our four-step investment process. That's because the valuation work we do is labor intensive and we would rather not eliminate a great wealth-generating company because it appears expensive based on a simple current results basis. We believe that it is worthwhile to analyze the company thoroughly and, if it is too expensive, monitor it until conditions change.

We consider many valuation metrics, but all models emphasize proprietary forecasted cash profits compared to the current cost of the business. For most companies, this is our forecasted three-year forward EBITDA over current enterprise value (EV). For financials we compare our projected adjusted pre-tax profits over modified tangible book value.

Importantly, we use this valuation work, along with proprietary revenue growth and profitability projections, during the conviction-weighting process to make quantitative assessments to manage risk and to rebalance the portfolio to optimal conviction weightings. As a result, the portfolio is populated with companies that are much faster growing, much more profitable and only modestly more expensive than the MSCI ACWI ex-US benchmark.

5. **What role does top-down analysis play?**

It's integral through many stages of our investment process. Given our long-term orientation, we try to glean investment trends based on economic development, political and cultural alliances, demographics, product innovation, labor mobility and numerous other factors. Upon deciding a company is well positioned and that it meets our quality criteria, we ask: Is the company doing business where it is favorable for them to do business? This requires building a geographic footprint that details, on a country by country basis, where a company is generating revenue. In addition, we evaluate the major countries where we have exposures based on detailed analysis of their economic momentum, demographics and trade sensitivity. The complete nature of our top-down work helps us identify threats on an ex-ante basis so that we can seek to protect the portfolios while benefiting from long-term trends.

6. **Do you hedge currency?**

We take great care to understand the revenue and cost sources of each portfolio company to naturally hedge currency risk; currency considerations are implemented through stock selection and portfolio construction.

As a first step, each company owned or under consideration is categorized as either domestic (it produces and sells in a single currency), global (it produces and sells around the world in local currencies) or exporter (it produces in one currency but sells in another). Domestic companies are generally insulated from currency swings. Global companies are impacted primarily through an accounting translation effect. Exporter/importer companies face operational risks from swings in currencies that effect revenues and profits.

Currency judgements are based on relative valuation and economic factors not on predictions. We try to avoid exposure where currency movement might negatively impact the portfolios—such as an exporter whose home currency is expensive. Alternatively, we want to be aware of situations where relative currency valuations could provide a tailwind to earnings.

7. **Your international portfolio has historically had 15—30% exposure to emerging markets. How do you determine those percentages and how do you manage risks associated with investing in EM?**

We have added value over the years by adjusting weights between emerging and developed markets. The primary drivers for us are valuation relative to our growth and profitability outlook adjusting for macro-economic risks. In all cases, we evaluate companies based on where they derive their revenue.

8. **You founded Chautauqua Capital Management in 2009 and joined forces with Baird in 2016. Can you talk about your motivation to join Baird and your experience so far?**

Over time we had been approached by other firms that were looking to strengthen, or build, their international/global equity offering, but on no occasion did they appear to be the cultural fit that Baird is. As a privately-owned company, Baird is able to take a long-term, client-first approach towards supporting our business and driving value for our investors.

Baird offered us the opportunity to remain an autonomous investment boutique while providing us with the strength and security of a privately-owned, leading financial services partner. The relationship continues to exceed our expectations and has allowed us to better focus on investing as Baird has assumed most operational and administrative services. As a result of Baird's investments, we've made two outstanding hires, launched mutual funds to better serve our client base and expanded our office space.

Brian Beitner, CFA, Managing Partner
Chautauqua Capital Management

Brian Beitner is the Senior Portfolio Manager for the Chautauqua International Growth Strategy and Chautauqua Global Growth Strategy. He formed Chautauqua Capital Management in January 2009. Prior to this, he was a member of the TCW Concentrated Core Equities portfolio management team from 1998, which was responsible for the management of up to $27 billion in assets. In 1999, he was named Director of Equity Research. In 2003, he became a Senior Equity Strategist. In 2005, Mr. Beitner began managing International and Global Equity portfolios. Prior to working at Trust Company of the West, he worked with Scudder, Stevens and Clark; Bear Stearns & Co.; and Security Pacific Bank in roles including portfolio management, research, and trading. He earned a B.S. in Public Administration and an M.B.A. from the University of Southern California, Los Angeles. He holds a certificate for Global Investing from INSEAD. He received his CFA charter in 1989.

IMPORTANT DISCLOSURES

Investors should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. This and other information can be found in the prospectus or summary prospectus. A prospectus or summary prospectus may be obtained from your financial advisor and should be read carefully before investing.

Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. Investments in international and emerging markets securities and ADRs include exposure to risks including currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Portfolio characteristics may change over time.

MSCI ACWI ex-U.S. Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed and emerging marketing excluding the United States MSCI EAFE Index: A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.