Aquila Opportunity Growth Fund

PODCAST TRANSCRIPT

OCTOBER 2021

Interviewer:
Hello, welcome to a special edition of the Aquila Group of Funds podcast series. We will speak with and introduce Pedro Marcal. He is Aquila's new Director of Equities and High Yield, as well as the Lead Portfolio Manager of the Aquila Opportunity Growth Fund. Pedro will discuss his hand-picked investment team, as well as the strategy and process of the Opportunity Growth Fund. Pedro, thank you for joining us.

Pedro Marcal:
Thanks, Phil. It's great to be here.

Interviewer:
Let's start with getting to know the team. Please tell us about yourself and the group you have assembled.

Pedro Marcal:
Sure. My name is Pedro Marcal, I joined in September 2021 as the Lead Portfolio Manager of the Aquila Opportunity Growth Fund. I am joined by a team of three colleagues with whom I have worked in the past. John McPeake, Steven Yang, and Dave Schiffman. What's important for me as the Lead Portfolio Manager is that we have had years of experience working together and that our areas of experience complement each other and provide complete coverage of all 10 GICS sectors. The coverage load is distributed in a balanced way, which was very important to me and purposeful in our team selection. For my part, I will be covering Energy and Consumer Staples, the two sectors where I have the most experience. My co-PM is John McPeake, whom I met when I joined Fred Alger in 2013 but I had been a fan of his work on the sell-side more than a decade earlier. I later recruited John to work with me at Foresters Financial.

John is responsible for the Technology sector, Communication Services, and part of the Consumer sector, including Internet Retail. He's been covering these sectors on the buy-side and sell-side for over two decades and really knows his stuff. Additionally, John will serve as my co-PM, which he is well-qualified to do, having previously run his own mid-cap tech portfolio.

John was working with Steve Yang when I joined him at Alger. Steven previously covered Healthcare for many years, but he was covering Industrials and Materials when we last worked together. Steven brings both breadth and depth to our team; covering Healthcare, as well as Industrials and Materials, is a unique capability, and on top of that, Steven brings hard analytical skills, being both a CPA, a certified public accountant, and a CFA®, a Chartered Financial Analyst® charter holder.

We're very lucky to have Steven on our team. I've been very fortunate to have worked with him for over five years already.

Finally, while John and I were at Foresters, we worked with Dave Schiffman, who was managing their insurance book of assets, which had its biggest allocation in corporate bonds. Dave is highly knowledgeable about interest rates and has spent his career analyzing interest rate-sensitive securities, banks, insurance companies, REITs, and utilities. Dave is responsible for the interest rate-sensitive sectors on the team. He covers Financials, Utilities, and Real Estate for the team. And it's an honor for me to lead this team here at Aquila.

Interviewer:
Thank you, Pedro. Thank you for the introduction on the team. So, let's shift over to why you're excited to lead the Aquila Opportunity Growth Fund's investment team.

Pedro Marcal:
Well, we're very excited to be at Aquila managing the Opportunity Growth Fund, and I'm thrilled to be leading this team with my colleagues. As you know, mutual fund investing is not an individual endeavor. Like so many competitive industries, investing requires individuals not only to have specialized knowledge and skills, but also to work well as a team. Steven, John, and Dave are all talented in their own right. They are also team players, and I have worked with each of them before, researching investments over the past decade, using a change-oriented investment framework.

Interviewer:
Let's talk a bit about the actual management of the Fund. You have an investment philosophy that is based on behavioral financial research. What does that mean, exactly? And how does it apply?

Pedro Marcal:
Sure, philosophically, I have two key beliefs about investing. My first belief is that earnings and cash flows drive stock prices. My

second belief is that markets are inefficient, and one of those inefficiencies is how they recognize and price change. There is an enormous amount of behavioral finance research that supports my view that markets have difficulty recognizing and pricing change. I think there are two main reasons for this. The first is that analysts and investors anchor their beliefs to the past. The second is that analysts and investors tend to be overconfident about their beliefs. It is the combination of these two—anchoring to the past and overconfidence—that causes analysts and investors to be slow to change their opinions, revise their estimates and alter their official recommendations when confronted with change. This is why inefficiencies arise, fundamentals change, but aren't recognized by the Street immediately. The word for this as hysteresis. It means delayed response to change. Because things change all the time and many people don't recognize these changes quickly, if we are faster to recognize change and understand the implications of change from an investment point of view, we're able to exploit those inefficiencies for our clients.

Interviewer:
Let's shift gears and talk about your stock selection process. How does the company get on your radar?

Pedro Marcal:
Idea generation and researching new ideas is really the most exciting and rewarding part of working in the investment business. Each new idea we research is potentially a material change for the company, which in turn, may represent an inefficiency that we can exploit for our client. Additionally, when you are fully invested, if you want to buy something, you have to sell something. So, every new idea challenges every existing holding in the portfolio, and drives the portfolio towards strengths and away from weakness. A constant flow of new ideas is an important part of our investment process. Our ideas come from three places. First, we get new ideas from sector-specific automated screens that our analysts use to screen for improving fundamentals. Second, we source ideas during our analyst meetings with companies, industry contacts, and specialists, up and down the supply chain. Each member of the team has a broad network of industry contacts with whom they speak regularly to ensure that we are aware of new trends and potential problems. We speak to the management teams of companies we own, but also to their customers, suppliers, and competitors. Finally, our analysts and PMs identify themes in the economy. Then our analysts research the best companies to take advantage of those trends.

Interviewer:
Let's take that a step further. So, the company gets on your radar. How do you ultimately determine whether to buy a company?

Pedro Marcal:
At the highest level, the answer to that is a thorough research process. We have a four-step research process that we apply whenever we identify a company for potential investment. First, we analyze the fundamentals of the company's business model and look for a material positive change at the company. We believe that stocks with the most potential upside are those experiencing positive change. These changes can be internal and company-specific, or they can be external and driven by the environment in which the company operates. Internal changes include a new product development cycle, an innovative new technology, or possibly a merger or acquisition. External changes include changes in industry dynamics or changes in a regulatory environment. Examples of these would include the rapid shift to online shopping from bricks and mortar that accelerated during the pandemic, as well as the Fed holding interest rates low and expanding their balance sheet.

Second, we look at the business model to assess the sustainability of the change. We have found through experience that strong businesses generally have what we refer to as "moats" that protect their business from competition. These protective business model characteristics generally fall into five categories, which are: 1) strong brand; 2) protected intellectual property; 3) protected licenses; 4) dominant market positioning; and 5) a resource advantage, such as access to a commodity or natural resource, or even a unique distribution channel. Some companies will have more than one moat, but typically one is most dominant and drives the business model.

Third, we quantify the magnitude of the change by carefully modeling the financials of each company and the impact of the change we expect on earnings and/or cashflow. We acknowledge where we may be wrong and build bull and bear earnings expectations that differ from our base case and incorporate different views.

Fourth, we utilize our model, as well as historical sector trading information, to build one, three, and five-year price targets that, again, look not just at our base case expectation, but also at the bull and the bear scenarios. It is crucial for us that potential investments have material upside to our price target. We gauge this by both calculating upside to our target prices, as well as reviewing street estimates of earnings s and price targets, to get a sense of where the market has already recognized the change. We consider adding companies to our portfolio only after they have passed through all of these steps in our evaluation process, and we feel confident in material upside to our target price.

Interviewer:
Final question, if I'm a shareholder or an advisor, how can you reassure me that my investment or my client's investment will be prudently managed?

Pedro Marcal:
I think prudent management is all about risk management and portfolio construction, and our team is intensely focused on these. Obviously, we diversify the portfolio across a large number of names, different industries and sectors, and we pay attention to the risks in the portfolio. We consider several kinds of risks in our portfolio construction process. We think about risk on the portfolio level, as well as on the company level. We consider relative risk to the benchmark, and whether our position brings us closer to or further away from, our mid-cap benchmark. We also calculate absolute risk at both the security and portfolio level, which is the downside that can occur if our assumptions are wrong, and there is a more negative outcome. We use individual position sizes and sector weights as tools to minimize risk, while still investing in the companies with the most compelling upside opportunities. All of these different lenses of risk are applied to each purchase and sale decision, as well as at weekly portfolio monitoring meetings that we have. It is important that we adjust position sizes over time as we view each company as it evolves and as we adhere to our strict sell discipline. At the end of the day, we ensure that the relative and absolute risks that we take are thoughtful and intentional.

Interviewer:
Pedro, thank you for your time today and for your insights and the team and the investment process. We're all very excited to have you on board. Have a great day.

Pedro Marcal:
Thank you. We're very excited to be here too.

Thank you for listening to this podcast. The opinions shared are those of the portfolio managers and do not necessarily reflect those of the investment advisor of the Fund. Information regarding holdings is subject to change and is not necessarily representative of the entire portfolio.

Mutual fund investing involves risk, loss of principle is possible. Investments are not FDIC insured, not bank guaranteed, not NCUA insured and may lose value.

Risks associated with Aquila Opportunity Growth Fund include, but are not limited to, potential loss of value, market risk, financial risk, interest rate and credit risk, and investments in highly leveraged companies, lower quality debt securities, foreign markets, and foreign currencies.

Please refer to the Fund's prospectus for a complete description of risks associated with an investment in the Fund. Before investing in a fund carefully read about and consider the investment objectives, risks, charges, expenses, and other information found in the Fund Prospectus. The prospectus is available from your financial advisor or when you visit www.aquilafunds.com or call 1-800-437-1020.

For certain investors, net investment income tax known as NIIT may apply. NIIT is a 3.8% tax established by the Patient Protection and Affordable Care Act that applies to the lesser of the net investment income or taxpayers modified adjusted gross income above an applicable threshold amount.

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