



Aquila Opportunity Growth Fund Updated Portfolio Holdings

PODCAST TRANSCRIPT
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Interviewer:

Hello, this is Matthew DiMaggio, Portfolio Strategist. Welcome, everyone, to a very special edition of the Aquila Group of Funds Podcast Series. Today, we have Pedro Marcal with us. He is our Director of Equities and High Yield, as well as the Lead Portfolio Manager of Aquila Opportunity Growth Fund. Pedro, as you know, we are hosting this podcast to discuss your first month managing the portfolio, and uncover the changes you and your team have made. So, let's dive right in, if that's all right.

Pedro Marcal:

Definitely.

Interviewer:

You and the current portfolio management team officially began managing Aquila Opportunity Growth Fund on October 1st, 2021. And congratulations, by the way, on the completion of your first full month. Aquila recently released updated portfolio holdings as of October 31st. So, let's discuss the updates. Can you summarize the portfolio changes that were made?

Pedro Marcal:

Yes, so it's true. We repositioned the portfolio during our first month, really our first six weeks. We always have work to be done, but we're very happy with where the portfolio stands today and excited about the opportunity here. We started the repositioning process by taking a hard look at the existing holdings and assessing the upside for each of the stocks in the portfolio. A couple of things stood out to us. First, we found some large positions in companies where we didn't see much upside potential for the stocks, particularly relative to the risks they represented. So, we wanted to eliminate those holdings. Our next step was to examine the mid-cap universe of companies that would better meet our investment criteria. And at the same time, adjust our weightings across sectors and industries. We were able to find some great ideas in the mid-cap space that weren't owned, where we saw a much greater potential for upside, and we're really pleased with where the portfolio is today. We initiated 40 new positions. A few of our largest positions are Arista Networks, Wolfspeed, HES, Synopsis, and Ford Motor Company.

Interviewer:

Great summary, Pedro. And based on the changes you've made, can you provide a little more color on the current view of the Fund in terms of sector allocation, top holdings, and overall risk and return statistics?

Pedro Marcal:

Of course. Let me say that Aquila Opportunity Growth Fund remains a mid-cap-focused, core Fund that seeks capital appreciation by investing in equities. The large majority of our shareholders are in the U.S. mid-cap space. We are stock pickers. That said, one of the natural consequences of our bottom-up stock-picking process resulted in overweights in Information Technology, particularly Semiconductors and Software. We are overweight Financials, especially Banks and Consumer Finance, and overweight Energy. Conversely, our largest underweights are Real Estate, Healthcare, and Utilities. Our top 10 holdings in order of size, starting with the largest are Arista Networks, Wolfspeed, Marvell Technology, HES, Splunk, Mattel, Synopsis, Ford, Broadridge, and Workday. Seven of these 10 companies are new to the portfolio.

We think about risk at the portfolio level and the company level. We think about it in absolute terms, as well as relative terms. We consider risk relative to our expected return from each stock over the next 12 months, and relative to the Russell Midcap® Index. During the rebalancing of the Fund, we increased the number of names in the portfolio from 74 to 90, increasing the diversification of the portfolio, reducing the absolute risk of the portfolio, as well as reducing the relative risk to the Russell Midcap benchmark, and increasing our forecast of expected returns.

Interviewer:

Pedro, can you go a little bit further into what went into the investment decisions you've mentioned? For example, how the portfolio management team applied its investment strategy and the research process in the decision-making.

Pedro Marcal:

This is a great team, and I have worked with all of the team members before. So, we are very much on the same page in terms of how we approach the research process. Our driving philosophy is that the best investment opportunities occur at companies experiencing positive changes. We are looking for a material positive change and a strong business model, which enable the company to monetize the change into higher earnings. We quantify the impact of the change into our financial model and price targets. And then we confirm it has not yet been recognized by the market. We typically source these ideas from three places. We

utilize sector and industry specific screens to review the entire investment mid-cap universe. The analysts find ideas through their regular reading and conversations with management teams and industry contacts. And then we also identify larger themes that we think will drive the opportunities over time.

Here are a few of the big ideas associated with the reallocation of capital within Aquila Opportunity Growth Fund. For example, the electrification of transportation is one of the themes that has led us to initiate positions in Ford, Wolfspeed, and Aspen. Electrification requires electronics and batteries. The electronics for high voltage applications, like electric vehicles, require silicon carbide chips, both inside the traction inverter or motor, as well as for the charging station. A typical wall socket delivers 120 volts of electricity, but the fast-charging car station requires 480 volts. And it gets very hot when that much power passes through the circuit. Chips made from silicon carbide are able to function efficiently at high temperatures with less cooling, smaller size, and longer life, and are, therefore, ideal for these types of uses. Wolfspeed is the dominant competitor in this market. They are years ahead of the nearest competitor and a huge beneficiary of the rapid adoption of electric vehicles. Separately, batteries used to power the electrification revolution are another key component. Aspen, a new investment for the Fund, is a Materials company that makes a microinsulation used to ensure these batteries operate safely.

Another theme is the slowing of Moore's Law. Gordon Moore was one of the pioneers of the Semiconductor industry and a co-founder of Intel. Gordon Moore observed that the number of transistors on a computer chip doubled every 18 months and cost half the price. Basically, you got twice as much computing power for half the price. This growing efficiency massively accelerated the adoption of computers as they became faster and cheaper. After decades of miniaturization, the size of the transistors became constrained by the wavelength of light. This caused a slowing of Moore's Law, and companies could no longer rely on the tailwind of ever-cheaper and faster chips, improving their products' performance, from the silicon to the software layer. This sparked a significant increase in demand for chip design software from the Electronic Design Automation, or EDA, companies. We bought two new positions in the Fund, in Synopsis and Cadence, that provide tools used to design and produce in this area. Cadence and Synopsis are essentially a duopoly that dominate in this growing area and are beneficiaries of the slowing of Moore's Law.

Interviewer:

Pedro, is there any particular portfolio change that you feel best exemplifies the team's investment approach?

Pedro Marcal:

The largest holding in the Fund, and a new holding, is Arista Networks. They supply the network fabric infrastructure and software for the Cloud, which handles a substantial amount of hyperscale web traffic. Clients would be the big companies in social media and the Cloud. Arista Technology is years ahead of the competition, and the company is seeing significant increases in visibility in their backlog of sales. We think the market is underappreciating and undervaluing the importance of their technology and the growth opportunity they are successfully executing.

Interviewer:

That's an exciting change to the portfolio. Now that you and your team have made initial portfolio changes, what would you say is next? How will you continue to search for investment ideas and help generate positive alpha?

Pedro Marcal:

We finished the portfolio repositioning at the beginning of November, which is great because now we can focus on one of our favorite parts of investing, which is finding new ideas. As a reminder, our ideas come from three places: our proprietary industry and sector screens, our meetings with companies and experts in the industries, and big overarching changes that are impacting companies like the ones we just spoke about. Each time a potential new idea is identified, we look for the positive change that we believe will drive the stock higher, we assess the business model for strength to maintain the change, and we look carefully at the valuation and earnings forecast to determine whether or not the Street has already priced in change that we see. Just as importantly, we look to see how the new idea will fit into our overall portfolio, whether it is better than our existing holdings, and what it does to the risk characteristics of the portfolio.

Interviewer:

I know that risk control and risk management are important aspects of how the team manages Aquila Opportunity Growth Fund. Can you talk about that in greater detail?

Pedro Marcal:

We think about risk at the company level and the portfolio level. When we look at a company, we calculate our expected return over one year, three years, and five years on our base case earnings forecast. We also look at bear and bull scenarios in case we're wrong about the base case. We think about the amount of risk that the position contributes to the overall risk in the portfolio, and we use this to rank our stocks by the risk they add to the portfolio. The stocks contributing the highest risks, that have the highest upside, where they get reduced. Conversely, if there's a lot of upside and not much risk being added by a stock in the portfolio, then that position gets increased. We have a very strict sell discipline. There are three reasons why we would

sell a company. First, the investment has succeeded and is fully valued, and we take profit. Second, we find a more attractive investment candidate and a stock is forced out by a more attractive investment. This is important because it drives the portfolio towards strength and away from weakness. And third, there's a negative change and we sell it. This sell discipline and risk management is very important to the way we manage our clients' money.

Interviewer:

Thank you for the fantastic detail, Pedro. That wraps up this edition of the Aquila Group of Funds podcast series. Thank you to all of our listeners. And thank you for joining us today, Pedro.

Pedro Marcal:

Thank you. It was great to be here.

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 adviser of the Fund.

Mutual fund investing involves risk. Loss of principal is possible.

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, when you visit www.aquilafunds.com, or call 800-437-1020.

Information regarding holdings is subject to change and is not necessarily representative of the entire portfolio. It is for informational purposes only and not intended to represent a solicitation to buy or sell any particular security.

The Russell Midcap® Index is representative of mid-cap stocks. Performance of an index does not reflect management fees and expenses, which are reflected in Fund performance. An investment cannot be made directly in an index.

For more information on the entire Aquila Group of Funds, please visit www.aquilafunds.com.