Looking Forward

Friess Associates market observations and insights

March 31, 2021

Onus on Earnings as High Expectations Raise the Stakes

Open for business. As birds chirp and the sun shines, state governments from coast to coast want the public to know that we are moving toward something resembling normal. There may be 50 different ways to get there, but the overriding trend favors reducing restrictions that limit traffic at gyms, movie theaters, restaurants and other destinations that function via in-person commerce.

Families with children on spring break snatched up all the Disneyworld resort reservations and theme park tickets available in March. Playing the increasingly favorable odds, Las Vegas raised casino capacity to 50 percent midway through the same month. Then the Texas Rangers went all in, announcing that its 40,000-seat Globe Life Field on opening day would host the nation's first full-capacity professional sporting event in more than a year.

Renewal, rebirth and growth are prominent themes at a fitting time of year. Spring is in the air, but so are new, more contagious variants of the novel coronavirus that threaten to detour the road to recovery. While our research is uncovering plenty of evidence to support forecasts for a robust and supportive economic backdrop, our strategy requires that we assess investment opportunities one company at a time. There's no such thing as an all-clear signal in this business.

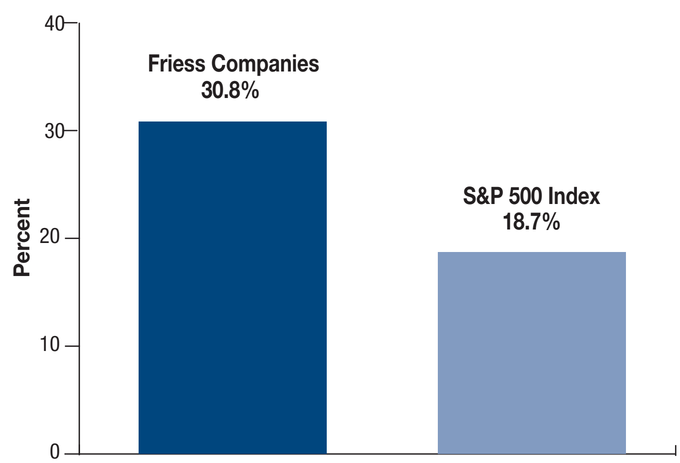
For the record, we hope we're on the verge of normal and that any recently relaxed restrictions prove to be well-founded harbingers of more to come. Still, no matter how positive things appear in aggregate, we recognize that we can't relax when it comes to potential risks, which in addition to potential for a Covid-19 setback include elevated valuations. Those valuations reflect high expectations, leaving little room for error.

With increased consumer savings and substantial progress in the nation's vaccination efforts, optimism seems reasonable. Government spending, from interventions to truncate the recession to ambitious plans for infrastructure investment, promises to contribute to sustained, above-trend growth.

The ISM Purchasing Managers Index showed that U.S. manufacturing expanded in March at the fastest pace since 1983, driven by the strongest growth in new orders and production in 17 years. Seventeen out of the ISM's 18 manufacturing industries posted growth in March. This and other data prompted the International Monetary Fund, or IMF, to revise its projected growth rate for the U.S. economy 1.3 percentage points higher from its January forecast to 6.4 percent, which would represent the nation's fastest growth rate since 1984.

Estimates for the first quarter of 2021 show earnings growth expectations climbing in this climate. As of March 31, analysts predict the companies in the S&P 500 Index will grow earnings 23.8 percent in this year's first quarter, up more than 50 percent from the consensus forecast on December 31. According to the company that compiled the numbers, "the first quarter of 2021 marked the largest increase in the bottom-up EPS estimate during a quarter since FactSet began tracking the quarterly bottom-up EPS estimate in Q2 2002."

Estimated Earnings Growth



Forecasted Increase in Earnings Per Share 2021 vs 2020

Source: Consensus estimates from FactSet Research Systems Inc., as of March 31, 2021.

This is not a forecast of future performance. Earnings growth for a portfolio holding does not guarantee a corresponding increase in the market value of the holding or the portfolio.

FactSet Research Systems cites numerous reasons for the record increase in first-quarter estimates, including analysts being overly aggressive in downward revisions for the first half of 2020, increased expectations for overall economic growth and higher commodity prices.

Companies themselves are also contributors to the trend. Through the end of March, 61 companies in the S&P 500 Index issued positive first-quarter earnings guidance, considerably above the five-year average of 35. Sixty-one represents the highest number of companies in the index providing positive quarterly earnings guidance since FactSet began tracking the metric 15 years ago. Positive guidance as a percentage of total pre-announcements at 64 percent show a complete reversal from the five-year average (35 percent).

The first quarter is expected to represent just the first installment in a year's worth of double-digit profit growth. Companies held in the portfolios we manage are expected to grow earnings 30.8 percent on average in 2021, according to consensus earnings estimates compiled by FactSet. The companies that make up the S&P 500 Index are expected to grow earnings 18.7 percent on average this year.

Like the space we occupy as a society somewhere between lockdown and anything goes, the companies we are currently isolating fall somewhere on the spectrum between extremes. They are neither stymied by the pandemic nor dependent on it. They tend to benefit from secular trends much more likely to influence their fates than the vagaries of the virus.

Avantor (page 4) benefited from the burst of activity that occurred as researchers studied the novel coronavirus and tested possible treatments for it. Still, that benefit came via the pervasive presence of the materials and consumables it supplies in the biopharmaceutical and health care markets rather than some unique link to the pathogen of the day.

The company's most recent results showed growth in all regions and end markets after adjusting for the one-time nature of Covid-19-related demand. As that source of business slows amid success in fighting the virus, Avantor is responding to resurgent demand in education and elective surgery markets that shrank during the more restrictive periods of the pandemic.

The comfortable foam clogs made by Crocs (page 4) seem as if they were made for a work-from-home world. As it turned out, Crocs was the only footwear brand among the top 30 to grow sales in March 2020 as the pandemic gripped the U.S. Sustained growth continued in the year since, but not just because Crocs round out the lower half of the perfect Zoom outfit.

Crocs collaborations with celebrities such as Ariana Grande and Justin Bieber contribute to an image that helped the company earn the "brand of the year" award from *Footwear News* in 2020. The company is pursuing a similar strategy in high-growth markets such as China, where actress Yang Mi embraces the brand. Crocs recently let Wall Street know to expect 20 to 25 percent revenue growth this year.

With prices for key crops such as corn and soybeans on the rise, The Mosaic Co. (page 5) benefits from positive pricing trends for the key fertilizing ingredients it produces. Spring planting for corn and soybeans fell below U.S. Department of Agriculture forecasts, making it likely that upward pricing pressure on phosphate and potash will continue. For more on trends in commodity pricing, please see page 3.

To ensure the safety of its workers, Winnebago Industries (page 5) idled production in early 2020 as the pandemic swept the U.S. Dealers shuttered amid lockdowns nationwide. The result, a $0.26 per share loss in the three months through May, was the iconic recreational vehicle (RV) maker's first quarterly loss in nine years.

The company was quick to adjust, restarting production in time to respond to a surge in demand driven by would-be travelers drawn by the freedom and safety afforded by Winnebago's RVs. Demand has been mounting ever since. Backlogged orders for motorhomes and towable RVs jumped 424 and 307 percent, respectively, in its most recently reported quarter.

We're encouraged by the robust earnings outlook and the supportive economic backdrop. At the same time, we know not to confuse reason for optimism as an excuse for recklessness. We're committed to prudently growing your assets by holding companies that deliver the kind of results that warrant share price gains.

Best wishes from your entire Friess team.

Scott Gates
Chief Investment Officer

Setting Up for a Supercycle?

A "supercycle" in the commodity market is defined as a multi-year and even decades-long period of time where a structural change in demand keeps supply constrained and prices elevated. The rapid industrialism of the United States in the late 19th century and post-war reconstruction in Europe and Japan in the 1950s are two examples. More recently, following a two-decade-long bear market, commodities rose in the early 2000s as China and other emerging counties turned toward internal growth. Evidence is mounting that we are on the cusp of another cyclical boom for commodities.

The global spread of Covid-19 quickly changed the demand profile for commodities. Prices reacted strongly to the crisis, reflecting changes in supply and demand due to policy measures to limit contagion before reversing quickly as the trend toward reopening economic activity accelerated. Beyond the health crisis and the sudden pause in commerce, many countries faced turmoil linked to commodity dependence and related supply chains.

Between the $935 billion spending bill passed in late December and the $1.9 trillion aid package of early March, the U.S. economy should see a staggering 15 percent of GDP worth of fiscal support. That's on top of the multi-trillion-dollar CARES act of 2020. At the same time, the Federal Reserve Bank is committed to keeping rates low for a lengthy stretch, creating a path for commodity inflation. After growing just 2.3 percent last year, China also looks to rebound on stronger exports and accelerating growth on the mainland.

Spot prices for crude oil turned negative for the first time ever in April last year as demand seized up during global coronavirus lockdowns. Prices recovered since then, currently standing above pre-Covid levels, amid hope that vaccines will help restore consumption. While not as widely discussed as crude barrel prices, related increases in chemicals and plastics prices are starting to show up around the globe.

Over the longer term, petrochemical demand is poised to increase due to the increased use of plastic in consumer goods globally. Polyvinyl chloride, or PVC, has seen a dramatic cost increase, driven by a combination of higher feedstock prices, rebounding global consumer demand and production outages from an unusual winter storm in Texas. The cost of high-density polythene, used for shampoo bottles and shopping bags, is its highest since 2008.

March nonfarm employment rose by 916,000, the largest increase since August 2020. Big gains in leisure and hospitality contributed as many states eased Covid restrictions. They were accompanied by strength in mining, logging and construction.

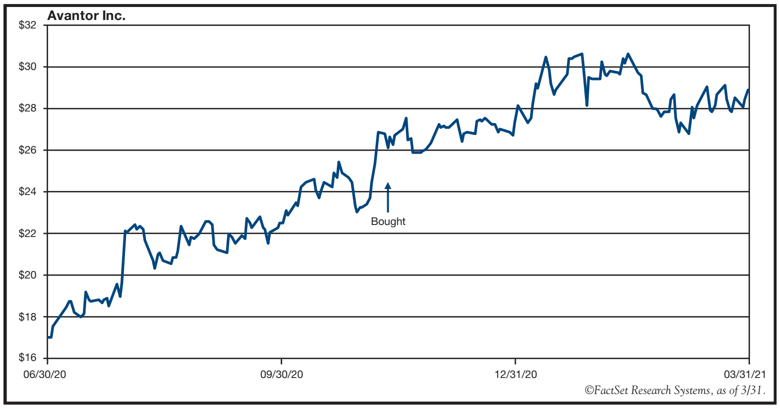
Lumber, one of the biggest costs in home-building after land and labor, has never been more expensive. The Covid-19 pandemic shuttered lumber mills in early 2020, handcuffing homebuilding crews all over the country and forcing home prices upward. The elevated price of lumber is in many cases easily adding more than $20,000 to the price of a new home at a time when housing supply is tight and demand is elevated.

Supercycles can be in part fueled by synchronized socio-economic policies across the globe such as those related to population growth, income inequality, climate change and decarbonization. For example, as demand from broad economic activity improves, mining and precious metals are also beneficiaries from new policies aimed at lowering carbon footprints. Copper and other metals are considerable components in solar panels, wind turbines, electric vehicles and batteries. Global automakers recently curtailed production because of a lack of semiconductor chips as well as shortages of nickel and cobalt used in batteries.

Corn and soybean prices on the Chicago Board of Trade rose significantly throughout 2020 to reach multi-year highs. Prices continued to rise in the first three months of 2021, driven by global demand, weather disruptions and plantings that came in under some industry estimates. After a wild year in 2020 for farmers that saw prices drop sharply only to recover by the end of the year, surging demand for proteins in emerging countries such as China is likely to continue. The weaker U.S. dollar against other major currencies also boosts export prospects for grains.

Concurrent global infrastructure spending is also increasing as a solution to help reaccelerate economies, again boosting demand for many commodities. President Biden's $2 trillion proposed plan includes massive new spending targeting transportation and utilities upgrades. Infrastructure development may also play a key role in the implementation of a European Green Deal and stimulus programs throughout Asia.

Avantor Inc., AVTR



The biopharmaceutical industry set a historic pace in taking novel therapies from research to full-scale distribution in the race against the Covid-19 virus. As a trusted partner to companies involved in all aspects of this response, Avantor plays a key role in helping the world stay healthy.

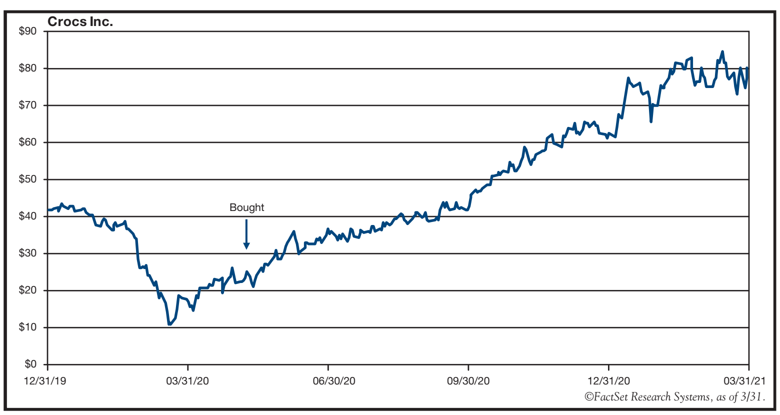
NYSE-listed Avantor Inc. provides mission-critical products and services to customers in the biopharmaceutical, health care, education and government, and advanced technologies and applied materials industries. Its portfolio of products is used in virtually every stage of research and production activities, reaching customer facilities in more than 180 countries. Sales grew 6 percent to $6.9 billion last year.

December-quarter earnings grew 53 percent, beating analyst expectations by 11 percent. Revenues grew 18 percent, driven by growth across all regions, end markets and product groups. While Covid-related business was behind some of the growth, trends accelerated even when adjusting for the one-time nature of the opportunity. The company continues to see a product mix shift toward higher-margin proprietary products in the biotechnology space.

Your team met virtually with Avantor's management team and discussed the company's capital allocation goals amid improving operating leverage. Free cash flow was $868 million in 2020, a 187 percent increase from $302 million in 2019. The improvement, driven by higher profitability, working capital improvements and reduced interest payments, allows the company to reduce debt while also adding capacity to its biopharmaceutical production.

Demand remains strong from biopharmaceutical customers, while education and elective surgery markets are stabilizing as vaccines roll out. Based on the consensus estimate, Wall Street expects Avantor to grow earnings 31 percent in 2021.

Crocs Inc., CROX



With foot traffic down amid various constraints, nearly every major shoe brand took a step back as the pandemic unfolded. Not so for Crocs. Comfort-minded consumers enthusiastically embraced the company's flagship clogs, and demand shows no sign of waning even as economic conditions become less restrictive.

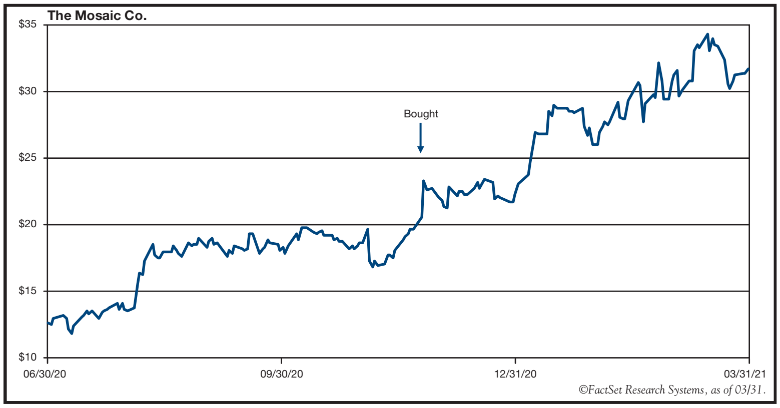
Nasdaq-listed Crocs Inc. makes casual footwear, apparel and accessories. The company is best known for colorful, lightweight foam clogs that prioritize comfort. Since launching in 2002, Crocs has sold more than 600 million pairs of shoes in more than 90 countries. Revenue increased 13 percent to nearly $1.4 billion in 2020.

From nurses working 12-hour shifts to work-from-home employees walking out to the mailbox, it's hard to imagine shoes better suited for the unique circumstances surrounding the pandemic. Market research firm NPD Group reported that Crocs was the only footwear brand among the top 30 to grow sales in March 2020, when the outbreak triggered lockdowns in the U.S. Demand remains robust a year later.

Crocs earned $1.06 per share in the December quarter, up from $0.12 in the year-ago period and 31 percent higher than the consensus estimate. Record quarterly revenue, up 57 percent from the year-ago period, closed out a record year.

While the debate about design appeal continues, the company ensures that Crocs remain fashionable, with support among high-profile celebrities such as Ariana Grande, Justin Bieber, Post Malone and Rihanna. Crocs forecasts 2021 revenue growth of between 20 and 25 percent, driven in part by increased penetration in China, where actress Yang Mi promotes the brand. Based on the consensus estimate, Wall Street predicts Crocs will grow earnings 20 percent this year.

The Mosaic Co., MOS



Corn and soybeans are selling near their highest prices in years, bolstering farmer finances. As a company focused on helping farmers capitalize on what they plant, Mosaic has seen demand and pricing for its nutrients and fertilizers soar.

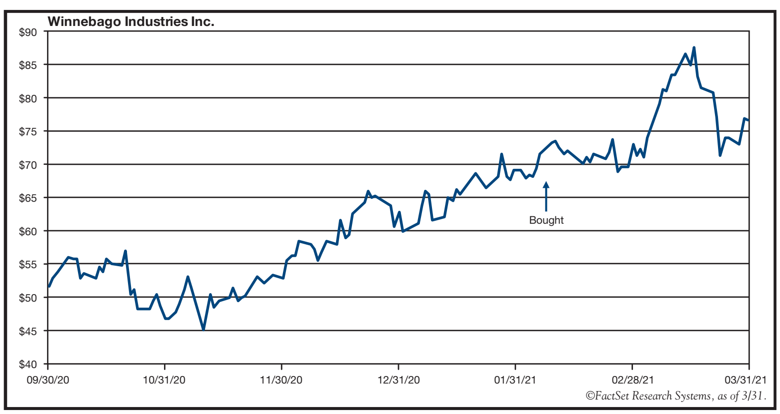
NYSE-listed The Mosaic Co. is the world's leading integrated producer of concentrated phosphate and potash, which are two of the three most important nutrients in agriculture. The company employs more than 13,000 people in six countries to serve farmers all over the world. Mosaic mines, produces and distributes millions of metric tons of phosphate and potash annually. Sales topped $8.6 billion in 2020.

December-quarter earnings grew to $0.57 per share from a loss of $0.29 a year ago. Sales increased 18 percent as commodity prices rose due to global supply conditions and large purchases by China, the first country to rebound economically from the pandemic. Farm economics improved materially across most geographies, while diminished inventories and limited supply in the U.S. market led to nutrient price improvements in the second half of 2020.

Your team spoke with Chief Executive Joc O'Rourke regarding the outcome of a trade case filed by Mosaic in the middle of last year. The U.S. International Trade Commission recently determined that subsidized phosphate fertilizer imports from Morocco and Russia materially injured the U.S. phosphate industry. As a result of this ruling, the U.S. Department of Commerce will issue countervailing duty orders on phosphate fertilizers, which will remain in place for at least five years.

Based on the consensus estimate, Wall Street expects Mosaic to grow earnings more than 200 percent in 2021.

Winnebago Industries Inc., WGO



The pandemic presents a dilemma that many people view as a choice between sticking close to home to minimize risks and venturing out into the world despite them. Others argue that owning a Winnebago renders that discussion moot by providing the safety and comforts of home anywhere the road may lead.

NYSE-listed Winnebago Industries Inc. makes recreational vehicles. The company builds motorhomes, travel trailers, fifth-wheel products and boats at facilities in Indiana, Iowa, Florida and Minnesota. Its brands include Winnebago, Chris-Craft, Grand Design and Newmar. The company generated about 95 percent of its more than $2.7 billion in revenue in 2020 in the U.S., with Canadian sales accounting the rest.

The revenue figure represented a 22 percent year-over-year gain, a remarkable feat considering the obvious obstacles presented by the pandemic. After overcoming challenges such as suspended manufacturing and shuttered dealerships early in the year, Winnebago readied itself to resume operations safely in time to offer customers a socially distant solution to the travel-stifling aspects of the pandemic as the weather turned warm. Demand grew with each passing quarter.

Revenue in the three months through February rose 34 percent to a quarterly record $840 million. Earnings for the quarter reached a record $2.12 per share, up from $0.67 in the year-ago period and 50 percent above the consensus estimate.

Chief Executive Michael Happe cited "strong retail demand, low field inventory and record committed dealer orders" as reasons for continued optimism as the company moves into the seasonally stronger second half of its fiscal year ending in August. Your team bought Winnebago at less than 11 times fiscal 2021 earnings estimates. The consensus earnings estimate puts the company on pace to grow earnings 178 percent in its fiscal year.

Acknowledging Past Mistakes Helps Us Find Our Best Ideas

The most celebrated stock investors of all time didn't earn their reputations with never-miss strategies or spot-on predictions. Any investor who boasts a pristine track record today surely will be humbled sometime soon. Successful investing, at its core, results from being right more often than wrong.

From currency fluctuations to production disruptions, company managements regularly revise guidance that only seeks to set expectations for the next quarter – and those are the people who run the companies. Trying to consistently hit the mark as an investor from the outside looking in is a formidable challenge.

We don't hesitate to admit when we're wrong. In fact, being wrong plays a noteworthy role in our investment strategy. It's obviously not an outcome that we seek, but we're prepared for it because we know it comes with the territory. Not planning for the inevitable raises the risk of compounding negative consequences.

The underlying premise of our investment strategy is that earnings drive stock prices. It's more involved than that, but we ultimately believe earnings performance is the most important fundamental factor in determining each company's share price. Since we seek companies with improving fundamentals, we sell companies when they report deteriorating fundamentals or, in other words, prove our assessment of them to be wrong.

This is one of the key elements of our sell discipline, and we're pretty unforgiving about it. Opportunity cost prompts us to move on. Why should we wait around for a company to navigate itself through disruption when we could just as easily redeploy assets into a company that isn't currently under duress? There's nothing to prevent us from revisiting the troubled company sometime in the future when the outlook looks brighter.

That kind of comparative thinking – what we hold now versus what's available – carries into another important facet of our sell discipline: forced displacement. Each day we ask ourselves whether we're putting the assets we manage to their most productive use, based on the individual-company forecasts we develop through bottom-up research.

Existing holdings must continuously earn their keep by showing more upside potential than a new buy we're considering based on their respective fundamental outlooks. The idea is to replace good ideas with great ones. Forced displacement triggers a sale when assets from an existing holding are needed to fund the purchase of a new, more promising investment opportunity.

We want to hold companies that will generate enthusiasm among investors. Since we believe earnings drive stock prices, we aim to hold companies that surpass investor expectations. The risk that a company will disappoint investors rises as investor enthusiasm grows, so we also sell companies when we believe consensus forecasts overstate a holding's true potential.

The fourth and, in the order of this discussion, final trigger in our sell discipline is also our favorite. We set price targets based on the earnings forecasts we develop internally, and we sell companies when they reach them. We're valuation-sensitive, so our price targets tend to be more conservative than aggressive growth investors who are willing to shoulder increased valuation risk.

Our sell discipline is part of a broader strategy that stresses the power of individual companies to influence their share prices through operational performance. We capitalize on the relationship between earnings results and stock prices by isolating companies poised to deliver rapid earnings growth that enjoy good prospects to exceed Wall Street earnings estimates. To maximize upside potential and minimize downside risk, we focus on rapidly growing companies that also sell at reasonable multiples of earnings estimates.

The portfolios we manage represent collections of our best ideas at a given point in time. Change is a persistent theme as the backdrop evolves and companies enjoy various degrees of success in executing their plans. We perform continuous research in an effort to hold companies poised to surprise to the upside.

Friess Investment Strategy Highlights

- Rapidly growing companies
- Reasonable price-to-earnings ratios
- Focus on companies likely to exceed consensus earnings estimates
- Emphasis on under-researched, lesser-known companies rather than industry leaders
- Intensive and repeated contacts with company management teams, customers, competitors and suppliers

On the Cutting Edge

Every so often, we like to highlight examples of innovative ideas that cross your team's radar screen. Chances to capitalize on investment opportunities related to them may lie in the future or may never materialize.

Replacing Battery Power Out of Thin Air

Wireless communications emit a lot of energy into the air. Efforts to harness that energy for practical applications so far yield limited results. With the dawn of the 5G-nertwork era, a research team at the Georgia Institute of Technology believes an opportunity exists to harness the free-floating power like never before. The Georgia Tech team noted in the journal Scientific Reports that the unprecedently high radiated power densities required to enable the fast speed and low latency of 5G ultimately creates "a wireless power grid capable of powering devices at ranges far exceeding the capabilities of any existing technologies." The grid can be tapped into using a process called millimeter-wave energy harvesting, which is limited in practical use by big, highly focused antennae used to facilitate it. To overcome this challenge, the Georgia Tech team designed a 3-D printed, flexible antenna about the size of a credit card that produces high-gain, wide-angle coverage using what is called a Rotman-lens-based array. As 5G becomes increasingly ubiquitous, the team believes its technology could replace tens of millions of batteries currently powering wireless sensors, especially ones used in smart city and smart agricultural applications.

Crops that Glow to Let Farmers Know

Farmers generally tend to their fields on a schedule, taking a one-size-fits-all approach that results in inefficiencies in the use of water, fertilizer and pesticides. The tendency is toward overuse in an effort to maximize yield, unnecessarily boosting costs and pollution. Calif.-based InnerPlant Inc. believes its technology can save farmers money while maximizing yields by equipping plants with the ability to communicate what they need and when they need it. The company genetically modifies crops to create what it calls "living biosensors." InnerPlant codes signaling capabilities into the DNA of crops to detect nutrient deficiencies, water stress and the presence of pathogens (bugs or fungi) within 24 hours of onset. The crops communicate their duress by fluorescing in one of three colors depending on the culprit. Invisible to the naked eye, the color change is picked up via satellite, with the data beamed to an online portal used by farmers growing InnerPlant crops. The fluorescing capabilities require no tradeoff in growth, hardiness or yield, according to the InnerPlant. The company's first product, InnerTomato, is undergoing testing in California. Soybeans are next on the company's agenda.

One-and-Done Solution to Pediatric Heart Valve Replacement

With some experimental alternatives, chemically treated materials derived from animals are most often used to replace malfunctioning hearts valves in children. While they serve their purpose well, they remain fixed in size, meaning they don't grow along with their hosts. That means implanted valves must be surgically replaced multiple times as kids progress into adulthood. Researchers at the University of Minnesota believe they could be on to a one-and-done solution. In experiments involving sheep, the researchers combined sheep cells and fibrin (a protein involved in blood clotting) within a tube-shaped bioreactor. Growth-encouraging proteins were added to prompt the combination to form a tube of biological material. The sheep cells were then removed with detergent, leaving behind a tubular collagen matrix. The researchers used the material to create replacement valves and implanted them in lambs. The valves essentially became the labs' biological material as their cells populated the matrix. Implanted valves increased more than 25 percent over a yearlong study period as the lambs grew.

Material Shows Bone-Like Ability to Strengthen Under Stress

Bones adapt over time to better handle the loads and forces to which they're exposed, going as far to repair themselves when fractured. Researchers at the University of Chicago developed a gel that they believe exhibits bone-like qualities by strengthening after exposure to vibration and its related stress. The team contends the gel represents the first man-made material to bolster itself under pressure rather than weaken. In testing, the material became 66 times stronger through exposure to mechanical vibration, with the boost most pronounced in areas specifically exposed to movement. The team took advantage of the piezoelectric effect, which gives certain materials the ability to generate an electric charge in response to mechanical stress, in designing the material. The charge prompts the component particles of the gel to cross-link, forming a second network within the material. The researchers see adhesives and medical implant integration as initial areas of potential application.

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As of March 31, 2021, Crocs Inc. and Winnebago Industries Inc. represented 1.81 and 2.36 percent of Friess Small Cap Growth Fund's assets. Other securities discussed were not held by the Fund. Earnings per share, or EPS, is the portion of a company's profit allocated to each outstanding share of common stock. The Price-to-Earnings (P/E) Ratio is calculated by dividing current price of the stock by the company's estimated earnings per share for the current calendar year. "Bought" date highlighted in stock charts represents the initial purchase date by Friess Associates. The S&P 500® Index is a capitalization-weighted index. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The index is unmanaged, unavailable for investment and does not incur expenses.

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