

# Managing Risk in Uncertain Markets With High-Quality Investments

Presented By



**fa-mag.com**

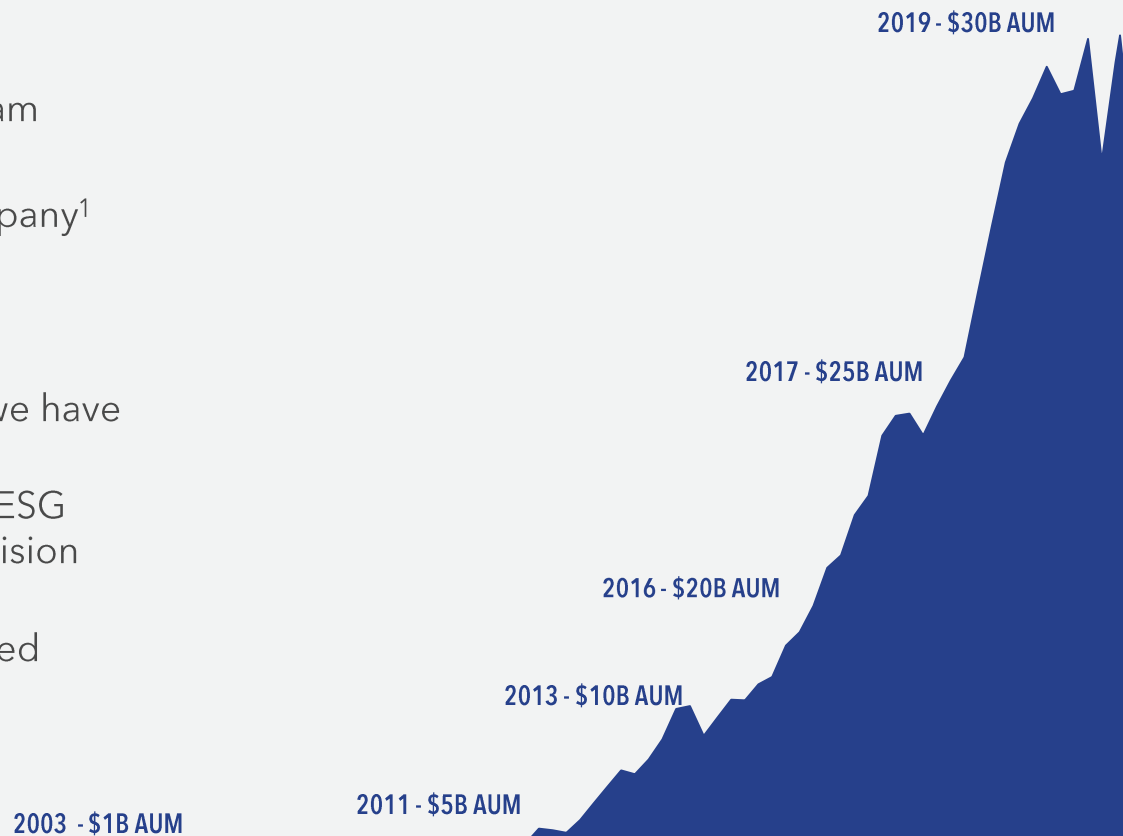
# A Pioneer in Responsible Investing

## Firm Overview

- Established in 1984 by Jerome Dodson
- Independently owned boutique
- Research driven
- Robust research internship program
- Fossil fuel free
- Largest pure-play ESG Fund Company<sup>1</sup>

## Principles and Performance®

- Responsible investing is all that we have ever done
- Fully integrate fundamental and ESG research in every investment decision
- Committed to seeking attractive, sustainable long-term risk-adjusted results



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<sup>1</sup> Morningstar Direct, as of 03/31/20. Based on AUM of fund managers solely offering ESG investment strategies.

Chart shows growth of the firm's AUM since 12/31/85 to the most recent quarter end. There is no guarantee that investment objective will be achieved.

# What Capital Strategists and Media Are Saying About Quality

With a challenging road ahead for the US economy recovering from the pandemic, we **favor large cap stocks with better balance sheets and greater earnings stability.**

...we expect economic recovery to be choppy and **continue to emphasize high-quality companies in our asset allocation.**

- LPL, May 2020

When it comes to equities, **it is already clear markets are favoring companies with high-quality balance sheets and reliable revenue streams.** This comes after a decade during which corporations were the only reliable buyers of stocks. Some often borrowed heavily to repurchase their shares.

- FA Magazine, May 2020

The divergence between stocks of different quality bands over the past month is following a historical pattern where **the highest-quality stocks preserved their capital better than the market during a downturn.**

- Morningstar, March 2020

...we **prefer looking for higher-quality dividend-paying stocks.** We believe that such names may have greater ability to sustain or increase their dividends. In addition, we found that Quality helps to sort out the impact of dividend changes: **High-quality Growers appear most attractive,** while lower-quality Cutters and Eliminators have suffered the worst performance among the cohorts.

- Morgan Stanley, May 2020



# Parnassus Mid Cap Fund Portfolio Managers

## Portfolio Managers



### Matthew Gershuny

MBA, University of Michigan &  
BA, Cornell University

Industry tenure: 23 years

Parnassus tenure: 14 years

Manager tenure: 12 years



### Lori Keith

MBA, Harvard Business School &  
BA, University of California, Los  
Angeles

Industry tenure: 25 years

Parnassus tenure: 15 years

Manager tenure: 12 years

## Investing Style

- Focus on quality
- ESG integration
- Focus on full market cycle returns
- Asymmetry of upside and downside capture
- Low turnover, high active share

## Morningstar Ratings™

Overall Rating™



Analyst Rating™

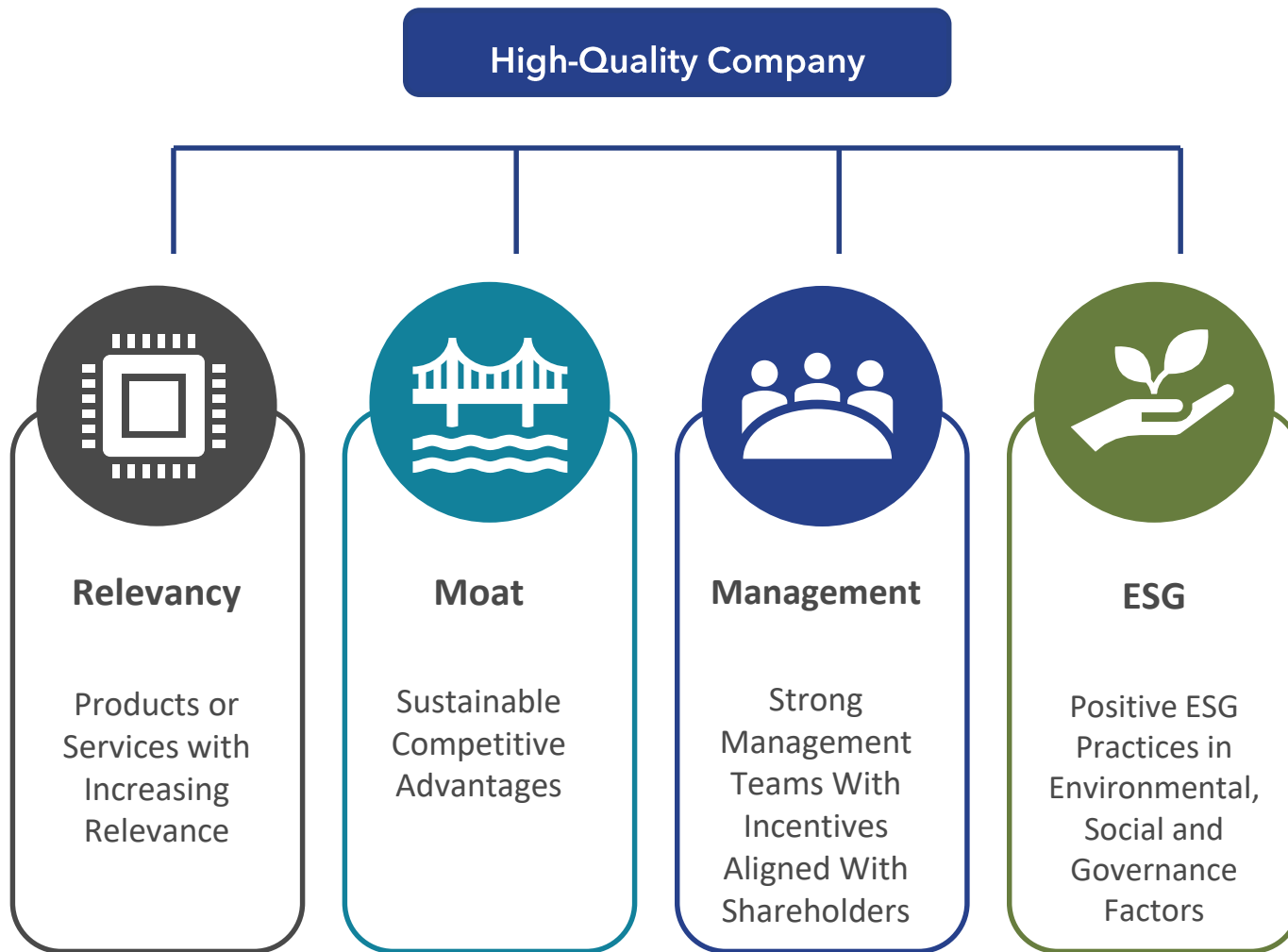


# Parnassus's Definition of a High-Quality Company

Businesses with increasingly relevant products or services, sustainable competitive advantages, quality management teams and positive ESG profiles.



# Parnassus Research Process



# Targeting Long-Term Relevancy

When a company's products or services are gaining share in the overall economy to help gauge their potential relevance to customers over at least the next three years.

## Assessment

- Addressable Market – Size and Saturation
- Current Penetration
- Industry Growth Rates
- Secular Trends

## Threats

- Risk of Disruption
- Substitution
- Change in Consumer Preferences



# Strong, Sustainable Moats

## Current and expected competitive advantage, or moat.

- High Switching Costs
- Sizeable Network Effect
- Regulation
- Low Cost Advantages
- Patents
- Brand



# Indicators of Strong Management Teams



## Management

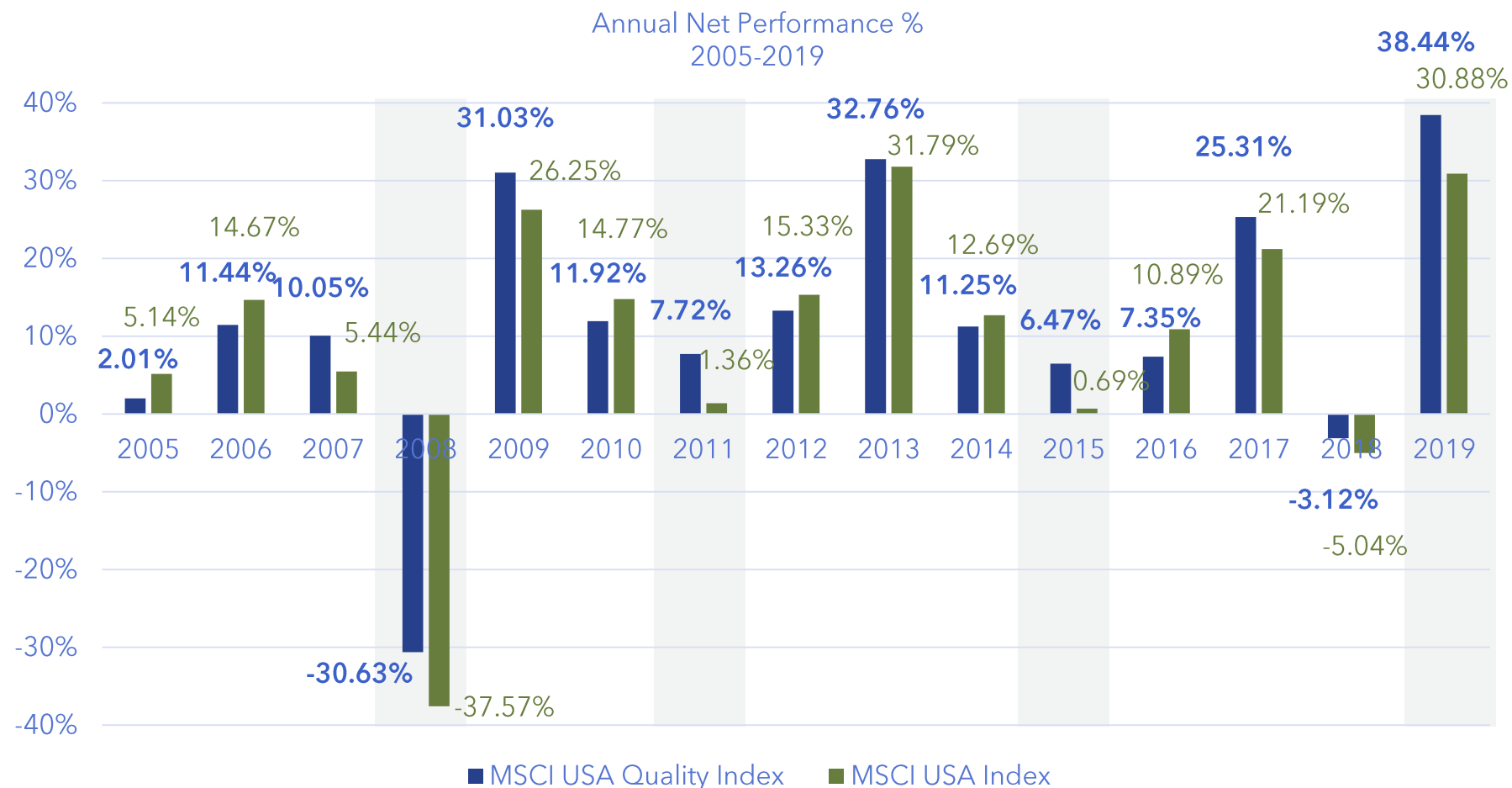
- Capital Allocation and Structure
- Incentives, Compensation Structure Align with Shareholder Interests
- Succession Planning
- Independent, Diverse Board Structure

# ESG Risks and Opportunities

## ESG Factors and Issues

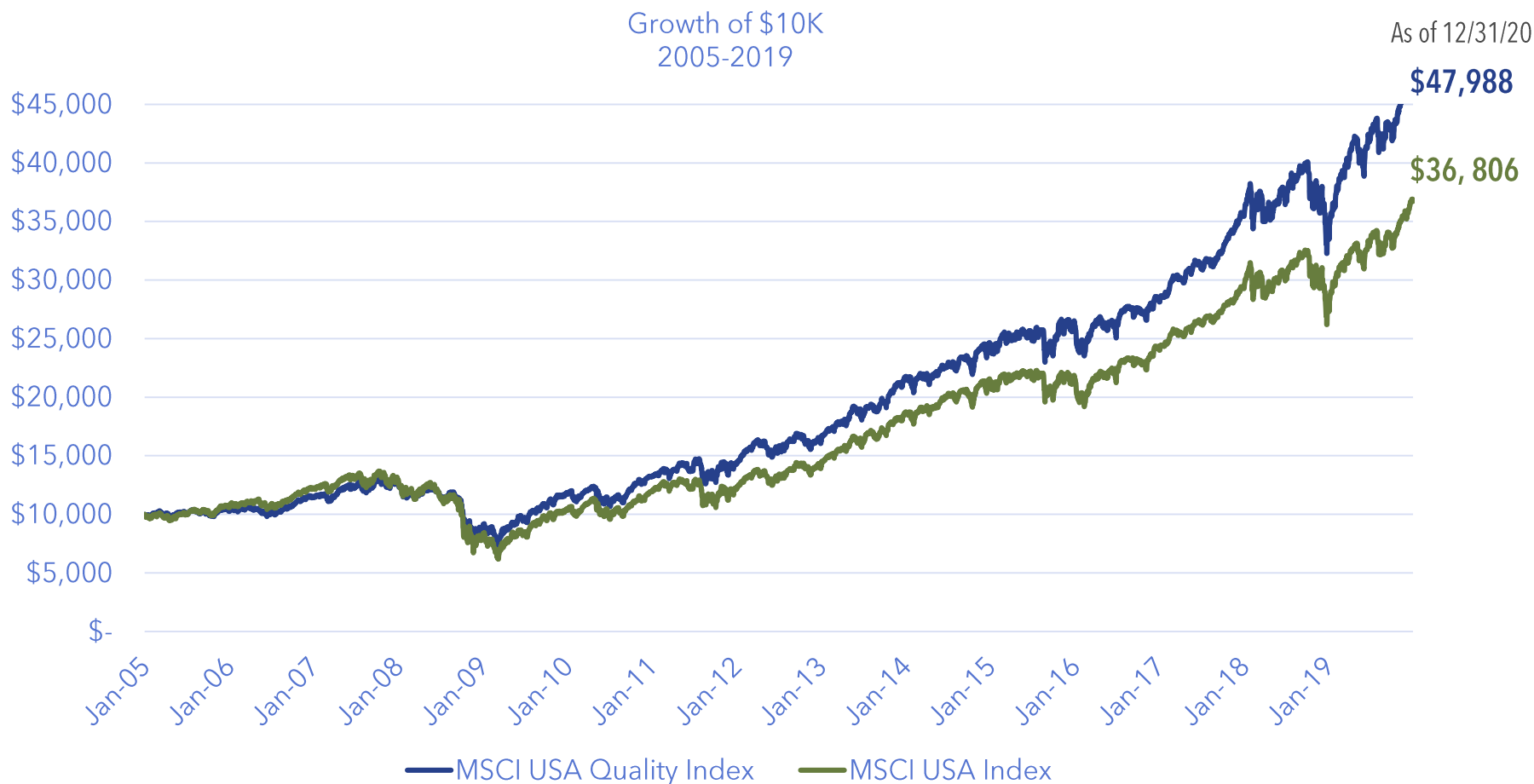


# Quality Has Historically Smoothed the Ride...



**Source:** FactSet as of 05/29/20. The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market. With 634 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US. The MSCI USA Quality Index aims to capture the performance of quality growth stocks by identifying stocks with high-quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage. Past performance is no guarantee of future results. Index returns assume reinvestment of any and all distributions and, unlike fund returns, do not reflect fees or expense. It is not possible to invest directly in an index.

## ...And Historically Delivered Long-Term Outperformance

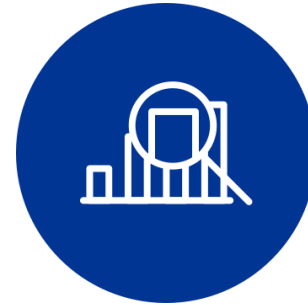


**Source:** Morningstar Direct as of 05/29/20. The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market. With 634 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US. The MSCI USA Quality Index aims to capture the performance of quality growth stocks by identifying stocks with high-quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage. Past performance is no guarantee of future results. Index returns assume reinvestment of any and all distributions and, unlike fund returns, do not reflect fees or expense. It is not possible to invest directly in an index.

# Determining Quality with Valuation Metrics

## Key Financial Indicators of Quality

- Asymmetric Risk/Reward
- Positive Free Cash Flow Generation
- Effective Allocation of Capital
- Healthy Balance Sheet
- Good Margin Structure
- Comfortable Levels of Leverage



# Quantitative Data Screens

- Standard Deviation
- Beta
- Upside/Downside Ratios
- Portfolio Turnover



# Qualitative Data Screens

- Top 10 Holdings
- Annual Returns During Down Markets
- Valuation Metrics
  - Price to Earnings
  - Price to Book
- Morningstar Moats



# Additional Resources

## Data Providers

- Morningstar
- Refinitiv Lipper

## Top-Tier Publications

- FA Mag
- Barron's
- Kiplingers

## Fund Companies

- Representatives
- Websites
- Thought Leadership



# Q&A

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Thank you.

# Important Information

**Price/Earnings (P/E) Ratio** is a ratio of a stock's current price to its per-share earnings over the past 12 months (or "trailing" 12 months).

**Price/Book (P/B) Ratio** is the ratio of a stock's latest closing price divided by its book value per share.

**Alpha** is a measure of performance on a risk-adjusted basis. Alpha takes the volatility (price risk) of a mutual fund and compares its risk-adjusted performance to a benchmark index. The excess return of the fund relative to the return of the benchmark index is a fund's alpha.

**Beta** is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. A beta of 1.00 means that the share price moves exactly inline with the market. A beta over 1.00 suggests that the share price will typically be more volatile than the market, and conversely, a beta below 1.00 indicates that the share price will typically be less volatile than the market.

**Standard Deviation** is a calculation used to measure the variability (risk) of a portfolio's performance.

**Active Share** is a measure of the percentage of stock holdings in a manager's portfolio that differ from the benchmark index.

**Upside/Downside Ratio** shows you whether a given fund has outperformed, gained more or lost less than, a broad market benchmark during periods of market strength and weakness, and if so, by how much. An upside capture ratio over 100 indicates a fund has generally outperformed the benchmark during periods of positive returns for the benchmark. Meanwhile, a downside capture ratio of less than 100 indicates that a fund has lost less than its benchmark during periods of negative returns for the benchmark.

**Moat** is defined as the competitive advantage of the business.

The **Morningstar Rating™** for funds, or "star rating," is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

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