There’s an old golf joke:
A con artist and his 800-pound gorilla convince an unsuspecting golfer into $1,000 bet that he can’t beat the gorilla in a round of golf. The confident golfer accepts the bet — and then stares in disbelief as the gorilla hits a 420 yard drive six inches from the pin on the first hole.

The con artist chuckles and says, “I told you, this gorilla can golf. Look, you seem like a nice guy. Give me $500 and I’ll call the bet off.” The relieved golfer accepts and agrees to finish the round for fun.

As they walk up the first fairway, the golfer asks, “By the way, how does the gorilla putt?”

The con artist responds, “Same as he drives. Straight as an arrow — and 400 yards!”

As every golfer knows, you can’t hit every shot the same way. Woods are often used from the tee box, irons in the fairway, wedges from the sand, putters on the green. But what if your ball is sitting in the high rough three feet off the green? Some golfers will use a wedge, others a hooded seven iron and others still a putter depending on a number of variables: the height and thickness of the rough, the pitch and speed of the green and the weather, among others.

The point is that the best golfers have to be flexible and experienced enough to be able to hit any of these shots (and others) depending on any number of factors. We think the same holds true for portfolio managers and their approach to managing money.
A disciplined approach
Research shows that over the past 20 years, broad market factors have driven about 65% of a global equity manager’s relative returns, with stock selection accounting for the remaining 35%.

Understanding that portfolio positioning has been responsible for the majority of returns, Applied Equity Advisors uses a flexible, yet disciplined, process powered by two engines. The first engine is the team’s proprietary Factor Timing Engine, designed to determine positioning with regard to broad market factors, and the second being our Stock Selection Engine.

In selecting stocks, Applied Equity Advisors seeks to choose those companies they wish to hold in the portfolio that can achieve the desired factor positioning from a style and regional perspective.

Applied Equity Advisors believes that the flexibility to intelligently position the portfolio, tilting toward or away from a certain style or region, depending on what the equity markets are favoring, is a critical differentiator in how we approach money management.

The importance of style flexibility
Imagine a second shot on a long par four, facing a headwind and water hazard directly in front of the green. Is it better to “go for it” and hit a five wood to the green or lay-up with five iron? The answer of course is “it depends”, based on any number of factors, but great golfers are flexible and experienced enough to hit either effectively. Similarly, a good investment manager needs to be able to effectively “hit” on more than a single type of stock.

Managers who are blindly beholden to only growth or only value will ultimately suffer when their style is out of favor. If you look over the past twenty calendar years (1999-2018), growth stocks have outperformed value stocks in nine of those years, with an average outperformance of +11.26%. Similarly, value stocks have outperformed growth stocks in the other eleven, generating an average outperformance of +8.78% (Display 2).

Clearly, being constrained by a robotic adherence to either growth or value stocks forces a manager to miss out on some significant return opportunities. Yet with a more flexible approach, the manager has the ability to adjust the portfolio to better capture the opportunity that the market is offering.

There is no substitute for experience
Every golfer knows that the more you play the “tough 12th hole” at the local course, the better you will shoot. While our investment process is based on the premise that having the flexibility to not be constrained by style can lead to improved performance, experience is a critical

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**DISPLAY 1**
Two ways to extract excess return

**MARKET FACTORS**

<table>
<thead>
<tr>
<th>MARKET FACTORS</th>
<th>65% of excess returns come from exposure to broad market factors</th>
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**STOCK SELECTION**

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<th>STOCK SELECTION</th>
<th>35% come from stock selection</th>
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**DISPLAY 2**
Style flexibility matters

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<th>RUSSELL 1000 VALUE</th>
<th>GROWTH BEATS VALUE</th>
<th>VALUE BEATS GROWTH</th>
<th>RUSSELL 1000 GROWTH</th>
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<th>GROWTH BEATS VALUE</th>
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<td>29.43</td>
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<td>2018</td>
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<td>6.76</td>
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Average when growth outperforms value: +11.26%
Average when value outperforms growth: +8.78%
HOW FLEXIBLE IS YOUR APPROACH?

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