



Best Ideas Only

A great growth company has earnings growth and revenue growth greater than the market in the long term. This is the type of company that also creates substantial shareholder value if held for a longer period of time. Cindy Starke, portfolio manager of the Value Line Larger Companies Focused Fund, follows the six-decade-old Value Line ranking system to find these fast growing companies and is prepared to hold them as long as they deliver.

What is the history of Value Line Funds and how has your Fund evolved?

Value Line Funds is one of the oldest mutual fund companies in the United States — it launched its first mutual fund back in 1950. Today we have over \$2 billion in assets under management with a diverse product offering that includes a variety of equity, fixed-income and hybrid mutual funds. Many of our funds utilize our proprietary Value Line Timeliness Ranking System as part of their investment process.

In the latter half 2014, we transitioned the Fund to a focused portfolio as we felt with fewer holdings and a higher conviction approach we could better achieve the Fund's investment objective of capital growth.

Today, the Value Line Larger Companies Focused Fund represents our “best ideas” in the large cap growth space and it targets ownership in a select group of 30-50 high-quality large-cap growth companies.

We benchmark against the S&P 500 Index, but about 75% of our assets are in the large-to-giant-cap growth quadrant, with market caps of \$17 billion or more. Our median market cap is \$43 billion. Having said that, we will also look at companies with \$1 billion market cap and up.

What are the tenets of your investment philosophy?

As growth investors, we are laser-focused on earnings growth as a primary driver of stock prices over time. We believe that buying great companies that consistently produce earnings growth, and holding them for the longer term, is the way to create value for shareholders.

A great growth company has earnings growth and revenue growth greater than the market for a long period of time. The S&P 500 Index as a whole is projected to grow sales at roughly 5% and earnings at 11% annually over the next 3 years, so my portfolio targets companies that are superior to those. Ideally, we are looking for earnings growth of 15% or greater over the next three years and sales growth of 10% or greater.

We also want their earnings and revenue growth to be sustainable, as opposed to growing 50% one year and then going flat the next. Some of our companies do not quite meet those hurdles but the current estimated 3-5 year earnings growth of our portfolio holdings is 19%, and our three-year sales growth is 14%.

I buy companies that can sustain faster growth, have great global brands with dominant market-share positions, are leaders in global industries with unique products or service, and have visionary management teams, healthy balance sheets and accelerating margins.



Cindy Starke has been a portfolio manager at The Value Line Funds since May 2014.

Starke joined The Value Line Funds with nearly 20 years of mid and large cap growth investment experience. Her experience includes the management of mutual funds, institutional and separately managed accounts. Starke manages the Value Line Income & Growth Fund, Larger Companies Focused Fund, the Value Line VIP Equity Advantage Fund and the Worthington Value Line Equity Advantage Fund. In addition, she is portfolio manager of the Value Line Tactical Rotation Strategy.

Starke began her investment career at U.S. Trust Company, where she worked as a portfolio manager and equity analyst in the Campbell, Cowperthwait division co-managing \$7 billion in large cap growth equity assets at their peak. She moved on with that investment team to become a founding portfolio manager at NewBridge Partners. NewBridge Partners was acquired by Victory Capital Management in 2003 where she was a co-portfolio manager of the Victory Focused Growth Mutual Fund and member of the Investment Committee. Subsequently, she has held senior equity portfolio management roles at Barrett Associates and Spears Abacus Advisors.

Starke received a B.S. in Business Administration from Fordham University and a M.B.A., with a concentration in Finance, from Fordham University.

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How does your fund differentiate itself in the market?

We're a "best-ideas" fund; we believe a portfolio should be built from the bottom up and not constrained by benchmarks. Our portfolio tends to be overweight certain sectors and underweight, or not active at all, in other sectors. Sometimes having an arbitrary cutoff causes you to miss out on a great company that is in a turnaround mode or is just about to hit an inflection point.

We do have core beliefs that guide our thinking and certain metrics we view as important, but nothing is absolute. We adapt them to where the company is in its life cycle, the business in which it operates. Generally speaking, we try to understand what is really relevant for each business.

How do you choose companies for your portfolio?

Earnings and sales growth are the two key metrics that we focus on because we want earnings growth to be sustainable and organic. We like to see 10%, or at least high-single-digit revenue growth, though not every company meets that mark.

We also want to see high and expanding margins so that we know the company will meet those earnings growth targets even if the business slows down. We like companies with flexible and scalable business models that have levers to gain margin expansion.

Some of the companies that we currently favor are Nike Inc, Estee Lauder Companies Inc, Starbucks Corp and Apple Inc; companies that have incredible brand strength and management teams, allowing them to benefit from insatiable global demand for their products. Most of these names are also doing something different, something unique, so each company has a special place in our portfolio.

We also focus on profitability metrics including return on equity and operating margins. Our companies recently averaged a 23% return on equity vs. 20% for the S&P 500 Index and had average operating margins of 25% compared to 21.4% for the S&P 500. These are very profitable companies.

What drives your research process?

We go through a multi-step research process.

Step One is about generating a lot of good ideas. The key here is not to miss any great stock for long, or in other words to avoid being out of the biggest winners. For this purpose, we use the Value Line Timeliness Ranking System, which gives us weekly rankings of approximately 1700 stocks relative to each other for expected price performance over the next 6-12 months, on a scale from 1 to 5, with 1-ranked stocks expected to be the strongest relative performers.

Twice a month we also run screens of stocks that show momentum, such as a 2 ranking that went up to 1. We produce a lot of ideas that

way. And, we rely on my 20 years of experience in stock selection and managing concentrated portfolios.

We do some things systematically, but we also leave room for some open-ended things. We run quantitative screens looking for the basics — high levels of projected earnings and revenue growth, high returns on equity, expanding margins and companies that are outperforming their peers. As we look for companies with accelerating trends, we want to know why a company is surprising or performing exceptionally well. Throughout this process, we attend conferences, read everything we come across and rely on our many years of experience evaluating companies. This is a humbling business and we want to be smart. We get ideas any way we can.

Step Two refers to our fundamental research process, a bottom-up analysis on the companies that make it past our initial screening and idea generation step. That is where we spend the bulk of our time. Every spot in our portfolio is valuable, so we need to make sure that we know our companies well, and that each one is fundamentally worthy. We look for consistent sales and earnings growth, both historically and going forward.

We look for companies with dominant market share or unique products and services, global brands that have access to the growing middle class, companies with high barriers to entry, solid balance sheets with low leverage and in very good financial shape. We look for business models that have scale, that have room for margin expansion, that still have many years of good growth ahead in their product cycle.

Because we do not want to miss out on great companies, we have to be flexible on valuation. We are not focused on an absolute P/E (price-to-earnings) number and we will pay up for really good growth. But a valuation that makes sense for growth is important.

Step Three is the decision to buy a stock, and with that comes portfolio management and portfolio sizing—how we are going to allocate the new stock in our portfolio. We generally buy stocks that are ranked 1, 2 or 3 in our Value Line Timeliness Ranking. If we are unsure about a company, we'll just wait and watch it for a quarter or two; we don't want to buy something and then have to sell it the next quarter. If we feel a company is good but not great, we'll just pass on it. We are not trying to own everything and we want to keep the portfolio focused.

How do you construct your portfolio? What benchmarks or strategy do you use for sector or relative position size?

We definitely put the most money in our high-conviction ideas. As of the end of March, our top 10 positions made up approximately 40% of the portfolio. We watch our smaller positions—maybe they are really interesting but had a bad quarter or are

a little riskier. We let their business models mature and add to them if we feel it is the right time. All in all, it's a dynamic process.

Our benchmark is the S&P 500 Index, but as growth investors we also pay attention to the Russell 1000 Growth Index. As far as portfolio diversification is concerned, we are a bottom-up, best-ideas fund, but at the same time we are trying to build a diversified portfolio.

Since most of our businesses are unique, there is little actual overlap, so we are not worried about being overweight in a sector. They are not really competing with each other.

We are usually overweight certain areas like consumer discretionary, healthcare, and technology, just because there are more growth stories there. It's more about going where the growth is than having a formula, which is what active management actually stands for. An active manager does not just maintain the same sector weighting as the indexes; they do not just manage to a number.

At the end of the day my job is to outperform my peers and the benchmarks, and the way to do that is not by managing to the sector weighting of any index, but by buying the best companies.

How do you define risk, and how do you measure and manage it?

We believe the best way to reduce risk is to run a diversified yet focused portfolio with companies you know well. We do not spread ourselves too thin. What we do instead is focus on companies whose businesses and business models we like and understand, and that alone controls a lot of risk. We spend a lot of time during our research process making sure we understand the downside and upside potential of every stock we own, trying to size our positions based on where they would be if the multiples contracted.

So, companies with the best risk/reward are at the top of the portfolio whereas riskier ones are at the bottom. We try to be smart and not too greedy.

We build a diversified portfolio not by sector but through an assortment of unique businesses. Studies have shown that if you have more than 20 holdings in a portfolio you have diversified away the risk, and we generally have 30 to 50. Also, high-quality large-cap companies tend to be on the less risky scale and we favor companies that are resilient, have strong balance sheets and are positioned to flourish regardless of the economic or interest rate environment. We feel that all those things combined with good management teams mitigate a lot of the risk.

When do you decide to sell a stock?

The easiest decision is when we have a new stock we really want to buy. Then it's Darwinian; if the new stock is an improvement to the portfolio, I sell my weakest holding. It is usually at the bottom of the portfolio, because it probably already has been trimmed due to a slowing growth rate or a bad quarter or two.

Otherwise it is much more difficult. Generally, we sell when a company's fundamentals are deteriorating or it is losing market share; when it has lower-than-expected sales or earnings, or margins going the wrong way. Management changes that do not make sense—if they brought in a new leader a couple of years ago and he suddenly leaves not for personal reasons—are another red flag.

So are mergers and acquisitions that do not make strategic sense or that lower a company's long-term growth rate or margin structure. They tell me the company is not as excited about its core business any more, that its best days might be behind it.

Value Line Larger Companies Focused Fund

Company	Value Line Funds
Symbol	VALLX
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Source: Company Documents

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I also will sell if a company is significantly overvalued because the market is just too optimistic, which will prevent us from making money on it, or when a stock's ranking drops to a 5. I want to keep the portfolio aligned for success.

In general, I am looking for easy-to-understand business models, straightforward businesses that have good controls in place. No one knows everything in this business. It is just about rightsizing your position, trying to build a portfolio of unique or focused companies that all do something differently. 



*ValueLine***funds**

The performance data quoted herein represents past performance and does not guarantee future results. Market volatility can dramatically impact the fund's short term performance. Current performance may be lower or higher than figures shown. The investment return and principal value will fluctuate so that an investor's shares, when redeemed may be worth more or less than their original cost. Past performance data through the most recent month end is available at vlfunds.com or by calling 800.243.2729. You should carefully consider investment objectives, risks, charges and expenses of Value Line Mutual Funds before investing. This and other information can be found in the fund's prospectus and summary prospectus, which can be obtained free of charge from your investment representative, by calling 800.243.2729, or by clicking on the applicable fund at www.vlfunds.com. Please read it carefully before you invest or send money.

The average annual returns shown above are historical and reflect changes in share price, reinvested dividends and are net of expenses. Investment results and the principal value of an investment will vary.

The Value Line Larger Companies Focused Fund was formerly named the Value Line Larger Companies Fund.

Top ten holdings for the Value Line Funds Larger Companies Fund can be found [here](#).

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