



The Rainier philosophy is simple. We invest in quality growth companies at prices that make sense. We believe that rewarding stock performance comes from companies with superior growth, attractive relative valuations, competitive strength, and financial integrity. Our decisions are based on fundamental analysis, which emphasizes bottom-up stock selection by sector specialists. We invest in all major market sectors because we believe that investment opportunities are found in industries that are frequently overlooked.

Sector Insights

Focus: Technology

Technology sector specialists: Mark W. Broughton, Stacie L. Cowell, Michael Emery, Peter M. Musser

Q: How does Rainier use its sector experts to manage a diversified portfolio?

A: At all times we work in sector teams, sitting in the same room, where each portfolio manager is immersed in industry fundamentals. Sector teams consist of two to four people, each of whom acts as both analyst and portfolio manager. Investment decisions are evaluated and executed at the sector level, and are reviewed by the entire team. This serves to provide full visibility and input across the team and adds further layers of oversight to decisions.

Q: What is Rainier's approach to buying stocks in the technology sector?

A: The technology sector is a significant group of industries with a large representation in each of our strategies as well as in the pertinent indices. We prefer companies with strong balance sheets that have above average potential for growth. Across all sectors, we integrate quantitative tools with traditional fundamental analysis to assist in executing efficiently and selecting stocks with growth at prices that make sense. While we're not required to hold stocks in every industry in the technology sector, we prefer to have exposure in each if there are attractive opportunities.

Q: How is the technology sector perceived in terms of being a "traditional growth" sector?

A: Probably more so than any other sector, technology has historically been known as the classic growth sector. It is the most

heavily-weighted sector within the growth indices for this reason. The constant innovation that takes place in the field of technology leads to a dynamic environment where there is almost always potential for growth opportunities. This is in contrast to some other sectors where companies may have the ability to grow faster than their peers, but innovation and new product development is less common. However, as the sector has matured, technology has taken on more cyclical growth characteristics.

Q: Are there any characteristics of the technology sector that differentiate it from the other sectors?

A: A unique aspect of the technology sector is that there are basically two distinct groups of customers. One is the consumer, which is you and me buying mp3 players, laptops, GPS devices, cell phones, etc. The other is enterprise, with purchases dominated by large Fortune 500 companies and the government. The sales cycle and the overall demand dynamics from these two groups are quite different. Enterprise customers have a longer sales cycle, typically purchase later in economic cycles, and their purchases are much larger on a transaction basis than those of consumers. The average sale in the enterprise space is upwards of one million dollars, whereas a typical consumer purchase might be one hundred dollars or less. Consumer sales tend to be early cyclical, with the sales cycle occurring much more quickly than enterprise customers. These two unique customer bases within technology allow us to alter the exposure within the sector, enabling us to incorporate our view of economic and industry trends in the context of our primary research: bottom-up fundamental analysis. While we had a tilt toward the consumer

customer base throughout 2009, we have now begun to emphasize companies that are more exposed to enterprise spending.

Technology is also an interesting sector in that the majority of the companies within the sector are inter-related. This makes working on sector teams very beneficial, as what is happening at the lower-end of the market capitalization spectrum has a large effect on what is happening at the upper-end of the market cap spectrum. For example, we can track the order patterns and inventory levels of small companies that are supplying components to a larger company like Apple Inc. This allows us to better evaluate both companies, and their current strategy and positioning relative to their competitors. Often we can use supply chain analysis to identify changes in fundamentals before company executives see the fundamental changes, enabling us to identify potential investment opportunities.

Q: What are the major industries and what is the sector team looking for in their investigation?

A: The major industries within technology are semiconductors, software, networking/telecom equipment, and other/computer hardware companies. The last category is comprised of a very small number of large companies, including Dell Inc., Hewlett-Packard Co., and Apple Inc. While companies across industries are inter-related in that they often work together at different points in the supply chain, each specific industry is unique and has its own trends and characteristics. For example, semiconductors trade much more as a group than software companies, which are more inclined to be priced on their own fundamentals. This occurs in part because the semiconductor industry is extremely cyclical in nature.

Within each industry, there are a number of key factors that help us identify attractive candidates. An important metric when analyzing technology companies is the rate of change of growth. Is growth accelerating or decelerating? We look for companies that are gaining market share within their respective industry, as well as those that have substantial room for growth, both of which are good indicators of the direction of future growth trends. If a company has captured a large percentage of the market for a specific product or service, it is less likely that it will be able to experience significant growth in the future. This often leads us to explore opportunities further down in the market capitalization spectrum, where companies that have lower market penetration and attractive growth opportunities can be found.

As mentioned earlier, another important fundamental indicator is inventory levels. If a company is ordering a large number of units, we want to know if the company is moving product out the door or if product is sitting in inventory. By closely monitoring order and inventory trends, we can further understand multiple companies within the supply chain.

Q: Are smaller companies able to compete and grow in this area of the market?

A: Technology as a sector is extremely capital-intensive. The amount of money that it takes to develop, produce, and market cutting edge technology products make the barriers to entry in this sector very high. Software is the one industry within technology where the barriers to entry are lower, as the fixed costs required to operate in this arena are much lower than for a company that produces a physical product on a large scale. Small software companies that experience success are often buy-out targets of large firms who may be having difficulty growing because they have reached a point of saturation with their own product or service.

Q: Can you elaborate on recent industry trends in the technology sector? What has changed in recent years, and what do you see changing in the future?

A: A major change that has occurred in technology in recent years is the way that software is delivered, specifically to the enterprise customer base. It used to be that large companies such as Oracle and SAP sold their database and application software on a 'perpetual license,' where there was a large sale that recognized revenue up front. The industry has recently moved to a 'software as a service' model (aka "SaaS model"), where software is sold as a contract and revenue is recognized monthly. This has led to changes in the growth rates of many of the companies in this industry.

Another recent trend that has been accelerating is the demand for bandwidth. With the rise of smartphones and other portable devices like netbooks and tablets, consumers are now accessing high definition video and other data wirelessly and at increasingly higher speeds. Existing network infrastructure cannot meet the current, let alone forecasted future, demand requirements. The infrastructure and technology needed to support this increasing demand is creating growth opportunities for companies that make products that increase bandwidth within the network.

The growth of data and the resulting demand for storage technology is a trend we believe will remain in place for the next several years. Increased competition and government regulation have elevated the importance of storage technology, as preservation of and access to data is critical for large enterprises. Data growth should continue unabated due to the proliferation of wireless and internet applications.

Within the technology sector, it is also imperative to recognize technology that has the potential to be disruptive. An example of this is Apple's impact on consumption of music. The iPod and the iPhone have revolutionized the way consumers access, store and pay for music. We are always looking for innovative technology with the potential to change consumer behavior and enterprise spending.

Next edition: Producer Durables

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