Mairs & Power Growth Fund Investor Class MPGFX

Analysis

Don't fret.
By Tony Thomas 4/1/2019

A few changes on its management team won't disrupt Mairs & Power Growth's established and proven process. The strategy retains its Morningstar Analyst Rating of Silver.

Two managers swapped positions on April 1, 2019, but this involves little more than title changes. As the firm's busy chairman and CEO, Mark Henneman ceded lead manager duties (which he's had since 2013) to comanager Andy Adams. Adams is a capable manager, having steered Mairs & Power Small Cap MSCFX to success since its 2011 inception. Adams also knows this strategy well, having supported Henneman long before becoming comanager in January 2015. They'll continue working together.

A new comanager--also added in April 2019--suggests an eye is on future succession. Pete Johnson has used the basics of this strategy as a separate-account manager at the firm, and as a member of the firm's 13-member investment committee (with Henneman and Adams), he has vetted prospects and assessed holdings' competitive advantages. Though the firm has made no formal announcement, indications are that Johnson could succeed Henneman on the strategy in coming years. If that happens, expect plenty of advance notice from the firm.

The personnel changes leave a proven process untouched. The strategy incorporates conservative growth expectations--just enough to beat the broader economy--and a preference for Upper Midwest firms. Those principles have led to a diversified, all-cap equity portfolio that favors established businesses with durable competitive advantages. The investment committee helps ensure consistent execution on these principles regardless of who's at the helm.

This approach has worked well over time. With a restrained notion of growth, it often lags in growth-led rallies (its light tech stake hurt in 2017, for example), but its patience with established companies helps in downturns. Similar patience has rewarded fund investors. From Henneman's January 2006 start through February 2019, the fund outgained its typical large-blend Morningstar Category peer and edged its S&P 500 benchmark.

Process Pillar: Positive
A proven approach with an analytical edge earns this strategy a Positive for Process.

Like all Mairs & Power strategies, this strategy's guiding principle is to buy and hold financially sound businesses with durable competitive advantages and above-average returns on equity. The managers also favor companies headquartered near the firm's St. Paul, Minnesota, office. Local knowledge gives the team valuable insights, but the regional preference does not keep the managers from investing elsewhere given the right opportunities. The firm's 13-member investment committee (which includes this strategy's three managers) ensures consistency. It vets prospective investments, generates a "buy list" to guide the managers' decisions, and evaluates firms' fundamentals and competitive positions.

The managers' conservative notion of growth might disappoint more-aggressive investors. They prefer firms that can grow sustainably over time, often at rates only slightly faster than the overall economy. As a result, the strategy is typically light on racy technology and biotech firms, embracing machinery makers and healthcare equipment suppliers instead.

The managers invest across the market-cap spectrum but think that larger businesses tend to have more competitive advantages. Small-cap holdings make capacity an issue, however, and the team estimates this $4.4 billion mutual fund could hold $5.0 billion.

The managers’ regional preference shapes a large portion of the portfolio. Firms based in the Upper Midwest (which the managers define as Minnesota, Wisconsin, Illinois, Iowa, and North and South Dakota) held about 56% of the fund's as-

Morningstar’s Take

Morningstar Analyst Rating: Silver

Morningstar Pillars

Process	Positive
Performance	Positive
People	Positive
Parent	Positive
Price	Positive

Morningstar Analyst Rating
Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

Analyst Rating Spectrum

Gold | Silver | Bronze | Neutral | Negative

Fund Performance

	Total Return %	+/- Category
YTD	15.14	-0.21
2018	-4.34	1.93
2017	16.52	-3.92
2016	15.38	5.01
2015	-3.07	-2.00

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Analysis

sets in December 2018. By contrast, only about 10% of the Russell 1000 Index comes from that region. The area's range of economic activities--from manufacturing to agriculture, banking, and healthcare--supports a diversified portfolio here. Many regional firms have global reach, including Ecolab ECL and 3M MMM.

To further diversify and thereby manage risk, the managers follow some key guidelines. They monitor the portfolio's sector exposure at the Morningstar Super Sector level, ensuring that its helpings of cyclical, defensive, or sensitive stocks don't deviate more than 10 percentage points from the benchmark S&P 500's levels. This clever move emphasizes stock-picking and diversification without forcing the managers into sectors that aren't suitable to their process. Additionally, they cap individual position sizes at 5% of assets.

The team also takes prudent steps when adding small- and micro-cap names to the all-cap portfolio. They typically keep such positions under 1% of assets each. That reflects the increased risk associated with smaller businesses such as supercomputer firm Cray CRAY or recent Honeywell spin-off Resideo Technologies REZI.

Performance Pillar: ⊕ Positive

Solid absolute and risk-adjusted returns and a relatively conservative performance pattern earn a Positive Performance rating.

The fund has looked good under Mark Henneman, its longest-tenured manager. From his January 2006 start through February 2019, its 8.7% annualized gain beat the 7.1% large-blend category average and edged the S&P 500's 8.5%. Although the fund tends to be about as volatile as the index (as measured by standard deviation), it usually keeps up in rising markets and loses a bit less in downturns. That gives it a slight advantage on risk-adjusted returns.

The fund's conservative performance pattern has been on display recently. The portfolio is typically light on technology stocks because the process favors companies growing just a little faster than the overall economy. That hurt the fund in calendar-year 2017, when its 16.5% return lagged the S&P 500 by more than 5 percentage points and trailed nearly nine tenths of its peers. Yet the fund held up better than most in 2018's volatile market, faring better than three fourths of its peer group.

Stock-picking explains some aberrations in the record. The fund flourished in 2013's broad market advance, with Minnesota-based St. Jude Medical and 3M leading the way. But it underperformed in 2015's choppy market when its few tech picks struggled, particularly Stratasys SSYS (now sold).

People Pillar: ⊕ Positive

A few changes to the management team make it deeper and better suited for the long run, keeping the strategy's People rating at Positive.

Mark Henneman is the longest-tenured manager here, but his duties have grown in recent years. He joined the fund in 2006, working under longtime manager Bill Frels. True to the firm's history of careful succession-planning, he became lead manager in 2013 about 18 months prior to Frels' retirement. He has since risen within the firm's leadership ranks, becoming chairman and CEO in January 2018. To make time for these responsibilities, he ceded lead-manager duties here to comanager Andy Adams on April 1, 2019.

Adams is a rising star at the firm. He joined this fund after Frels' retirement and augments this portfolio with smaller companies (often from his Mairs & Power Small Cap, which launched in 2011). Adams is now the firm's CIO.

Pete Johnson's appointment as comanager in April 2019 adds support for the busy Henneman and Adams. Johnson came to Mairs & Power in 2010 and has served on its investment committee from the start. Johnson could be a long-term successor to Henneman, though Henneman remains on the fund for now. All three managers sit on the firm's 13-member investment committee that ensures consistent execution and provides additional research. Members average nearly 25 years of industry experience.

Parent Pillar: ⊕ Positive

A series of smooth leadership transitions bodes well for Mairs & Power's long-term stability, earning the firm a Positive Parent rating.

An anticipated retirement from the St. Paul, Minnesota-based firm set changes into motion. Former chairman and CEO Jon Theobald stepped away at the end of 2017. Mark Henneman, then the firm's president and CIO, took his place. Andy Adams, lead manager of the firm's small-cap strategy, became CIO, while Rob Mairs--a descendant of the firm's founder--took the presidency. Each is settling into his respective role. Mairs, who left legal practice to join the firm in 2015, is promoting efficiency by consolidating the firm's operational activities. Henneman and Adams are capable defenders of the firm's well-established, conservative investment approach that favors Upper Midwest companies.

The firm has navigated other changes equally well. When Ron Kaliebe announced his retirement from Mairs & Power Balanced in April 2018, it promoted Kevin Earley to lead manager and Bob Thompson to comanager to work alongside Kaliebe until his final day in June 2019. The firm has also fleshed out its trading staff, added a dedicated quant analyst, and has plans to hire other research support. The moves align the 88-year-old firm's resources with its size and the demands of modern investing while keeping its traditions intact.

Price Pillar: ⊕ Positive

Below-average fees earn this fund a Positive Price rating.

The fund's only share class--the no-load Investor class--is attractively priced. Its 0.64% expense ratio is well below the 0.88% median for similarly distributed shares. Fees have come down a little over time: In 2013, the expense ratio was 0.67%.

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The managers' low-turnover style keeps trading costs down, but buying and holding some winners means the fund sits on unrealized capital gains. The fund typically distributes capital gains annually, most of which are tax-advantaged long-term capital gains. Modest outflows could force the realization and distribution of more gains. An estimated $592 million left the fund in 2018.

Morningstar 2019 Analyst Report: Mairs & Power Growth (MPGFX)

The Funds' investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus and summary prospectuses contain this and other important information about the Funds, and may be obtained by calling Shareholder Services at (800) 304-7404 or by visiting www.mairsandpower.com. Read the prospectus and summary prospectuses carefully before investing.

Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Funds may be lower or higher than the performance quoted. As of the prospectus dated April 30, 2019, Mairs & Power Growth Fund, Mairs & Power Balanced Fund, and Mairs & Power Small Cap Fund have annual expense ratios of 0.64%, 0.72%, and 1.04%, respectively. For the most recent month-end performance figures, visit the Funds' website at www.mairsandpower.com or call Shareholder Services at (800) 304-7404.

Average Annual Total Returns for Periods Ending December 31, 2019

	1 Year	3 Years	5 Years	10 Years	20 Years	Since Inception
Mairs & Power Growth Fund[1]	28.39	12.69	9.86	12.97	9.89	11.38
Mairs & Power Balanced Fund[1]	20.32	9.39	7.28	9.78	7.64	9.59
Mairs & Power Small Cap Fund[1]	21.13	6.67	8.05	N/A	N/A	14.84
S&P 500 Total Return (TR) Index[2]	31.49	15.27	11.70	13.56	6.06	N/A
Composite Index[3]	22.64	11.00	8.45	9.87	6.00	N/A
S&P 600 Small Cap Total Return (TR) Index[4]	22.78	8.36	9.56	N/A	N/A	N/A

(1) Performance information shown includes the reinvestment of dividend and capital gain distributions, but does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares.

(2) The S&P 500 TR Index is an unmanaged index of 500 common stocks that is generally considered representative of the U.S. stock market. It tracks both the capital gains of a group of stocks over time and assumes that any cash distributions, such as dividends, are reinvested back into the index. It is not possible to invest directly in an index.

(3) The Composite Index reflects an unmanaged portfolio of 60% of the S&P 500 TR Index and 40% of the Bloomberg Barclays U.S. Government/Credit Bond Index. It is not possible to invest in an index.

(4) The S&P SmallCap 600 Total Return Index is an index of small-company stocks managed by Standard & Poor's that covers a broad range of small cap stocks in the United States. The index is weighted according to market capitalization and covers about 3-4% of the total market for equities in the U.S. It tracks both the capital gains of the group of stocks over time and assumes that any cash distributions, such as dividends, are reinvested back into the index. It is not possible to invest directly in an index.

The statements and opinions are those of the author as of the date of this report. All information is historical and not indicative of future results and subject to change. The reader should not assume that an investment in the securities mentioned was or would be profitable in the future. This information is not a recommendation to buy or sell. Past performance is not indicative of future results. Diversification does not eliminate the risk of experiencing investment losses.

All investments have risks. The Funds are designed for long-term investors. Equity investments are subject to market fluctuations and the Funds' share prices can fall because of weakness in the broad market, a particular industry or specific holdings. Investments in small and midcap companies generally are more volatile. International investing risks include among others political, social or economic instability, difficulty in predicting international trade patterns, taxation and foreign trading practices and greater fluctuations in price than U.S. corporations. The Balanced Fund is subject to yield and share price variances with changes in interest rates and market conditions.

Investors should note that if interest rates rise significantly from current levels, bond total returns will decline and may even turn negative in the short-term. There is also a chance that some of the Balanced Fund's holdings may have their credit rating downgraded or may default. The Small Cap Fund may invest in initial public offerings by small cap companies, which can involve greater risks than investments in companies that are already publically traded.

As of 12/31/2019, the Growth Fund has a Morningstar Rating of 3 stars Overall and 3 stars, 3 stars and 3 stars, for the 3-, 5- and 10-year periods among 1203, 1203, 1058 and 808 large blend funds, respectively, based on Morningstar Risk-Adjusted Return. 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 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.

The stocks mentioned herein represent the following percentages of the total net assets of the Mairs & Power Growth Fund as of December 31, 2019: 3M Company 4.00%, Cray 0.00%, Ecolab, Inc. 3.90%, Honeywell 2.06%, Residio Technologies 0.00%, St. Jude 0.00%, Stratasys 0.00%. All holdings in the portfolio are subject to change without notice and may or may not represent current or future portfolio composition. The mention of specific securities is not intended as a recommendation or offer for a particular security, nor is it intended to be a solicitation for the purchase or sale of any security.

Standard Deviation is a statistic that measures the dispersion of a dataset relative to its mean and is calculated as the square root of the variance.

The Russell 1000 Index is an index of approximately 1,000 of the largest companies in the U.S. equity market. It represents the top companies by market capitalization. It's not possible to invest in an index.

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