

Focus

Portfolio Commentary | September 30, 2023

Summary

- US stocks recorded their first negative quarter of 2023 despite easing inflation, as investors struggled with the new reality of higher-for-longer interest rates. Higher rates appeared to curb the advance of an equity market powered by richly valued technology stocks. The tremendous outperformance of the seven largest companies, known as the "Magnificent Seven," is unlikely to escape the bond market's gravitational pull much longer.
- Mar Vista's Focus strategy modestly trailed the Russell 1000® Growth Index and S&P 500® Index during the third quarter.
- The third quarter's top contributors were Intuit, Alphabet, and Adobe. The top detractors were Microsoft, Apple, and American Tower.
- We added to our investments in Oracle, Disney, and Nike during the quarter. Strong stock price movement motivated us to trim our investments in Apple, Adobe, Berkshire Hathaway, and TransDigm.
- Equities head into the final months of 2023 troubled by the possibility of higher-for-longer interest rates tipping the economy into recession.

Commentary

After a robust first half of 2023, US stocks recorded their first negative quarter for the year despite easing inflation, as investors struggled with the new reality of higher interest rates for longer. Higher rates appeared to curb the advance of an equity market powered by richly valued technology stocks. Excitement around artificial intelligence and signs of subsiding inflation without a recession had propelled the S&P 500® Index to its best first half since the 1980s.

The outperformance of the seven largest companies, known as the "Magnificent Seven," is unlikely to escape the bond market's gravitational pull much longer. The combined group of Apple, Microsoft, Alphabet, Amazon, Tesla, Nvidia, and Meta account for approximately one-third of the S&P 500® Index and three-quarters of its appreciation year to date. Given that the primary driver of stock price performance from this cohort was multiple expansion, some of these equities are priced for perfection. The third quarter exposed some of the first cracks in this market leadership.

Performance Review

Mar Vista's Focus strategy declined -4.60% net of fees in the third quarter of 2023. The Russell 1000® Growth Index and the S&P 500® Index returned -3.13% and -3.27%, respectively. Year to date, the portfolio returned +12.31% net of fees versus +24.98% for the Russell 1000® Growth Index and +13.07% for the S&P 500® Index. Stock selection within industrials, consumer discretionary, and healthcare, along with our lack of energy exposure, negatively impacted performance during the quarter.

The portfolio's overweight in real estate also detracted from performance as **American Tower** struggled this quarter in response to the Fed's higher-for-longer interest rate stance pressuring the stock down -15.21%. Higher-cost debt creates a modest headwind for free cash flow growth and lowers the present value of American Tower's long duration assets. Other factors pressuring American Tower's stock include slowing 5G investment spend, skepticism over DISH

Networks' ability to fulfill its spectrum buildout requirements, and a stronger dollar dampening the value of international cash flows. While higher rates are creating a 2-3% headwind to near-term free cash flow growth, we believe American Tower's secular growth and value drivers remain intact and the stock price represents an appropriate margin of safety, or discount to intrinsic value.

The technology sector also suffered in the third quarter after flying high the first six months of the year. Our investments in **Apple** (-11.61%), and **Microsoft** (-7.08%) were among the portfolio's biggest detractors.

Apple's stock faced downward pressure due to concerns among investors regarding diminishing smartphone demand, intensified competition from Huawei, and the Chinese government directives limiting iPhone usage by government officials. Despite these short-term challenges, our conviction in the company's enduring competitive advantages remains steadfast. Apple derives substantial benefits from its extensive ecosystem, boasting an installed base exceeding 2 billion devices and over 1 billion paying subscribers for monthly services. We anticipate that this robust Apple ecosystem should underpin a more predictable cash flow trajectory, fostering high single-digit growth in intrinsic value over our investment horizon.

Microsoft continues to occupy a strong position, poised to capture market share as businesses, both large and small, navigate the transition to a digital-first landscape and embrace generative AI-driven solutions. The company's commanding presence in the enterprise arena, combined with its comprehensive product portfolio encompassing Infrastructure-as-a-Service (IaaS), Platform-as-a-Service (PaaS), and Software-as-a-Service (SaaS), establishes it as a crucial provider of IT solutions for companies of all scales. Microsoft is effectively executing its strategy in a sizable market opportunity by offering businesses a roadmap for digital transformation and adoption of cutting-edge AI-driven solutions, such as ChatGPT, while enhancing productivity and reducing costs. Consequently, we anticipate that Microsoft's solutions should exhibit resilience even in a more challenging macroeconomic environment, supporting low double-digit growth in intrinsic value within our investment horizon.

Alternatively, **Intuit**, **Alphabet**, and **Adobe** are the portfolio's top contributors for the quarter, appreciating +11.71%, +8.99%, and +4.28%, respectively.

Intuit is reaping the rewards of the transition to digitally-driven, cloud-based solutions, in conjunction with a steady macroeconomic environment for small businesses. QuickBooks provides a comprehensive array of indispensable business applications that foster heightened productivity and efficiency gains for small business proprietors. This suite of small business applications not only attracts new subscribers to the QuickBooks ecosystem but also encourages existing customers to further embrace additional solutions. Furthermore, Intuit's TurboTax offerings persistently wrest market share from premium-priced tax service providers, significantly expanding TurboTax's addressable market. Intuit is strategically positioned to capitalize on the emerging trend surrounding generative AI, having seamlessly integrated generative AI features and functionality into its product suite. Given these factors, we maintain our conviction that Intuit is well-positioned to achieve upper-teens growth in intrinsic value over our investment horizon.

Alphabet's second quarter financial results beat expectations on both revenue and earnings, demonstrating accelerating fundamental performance against low expectations. Notably, YouTube is returning to positive revenue growth, search performance is accelerating, and cloud profitability is improving. As a leader in generative AI, Alphabet benefits from one of the most disruptive trends in technology. Its data advantage, global two-way distribution, cloud infrastructure, and willingness to invest in AI are critical competitive moats. These factors position Alphabet to improve and disrupt general search with more personalized, conversational, and interactive AI experiences. Over the near-term, the company's durable advantages and upside potential from expense management should allow intrinsic value to compound mid-teens, barring a recession.

We continue to believe that **Adobe** maintains a strong competitive position within the Creative Professional market and will benefit as more commerce migrates to digital channels and generative AI becomes mainstream. Adobe is an early leader in the budding generative AI market as it has stand-alone generative AI solutions, like Firefly, and generative AI features/functionality integrated into its flagship solutions, like Photoshop. The early lead in generative AI is winning

Adobe greater mindshare within the Creative Professional market, which is translating into mid-teens growth year-on-year in constant currency for annual recurring revenues and reported revenues. This supports our view that Adobe will continue to grow intrinsic value mid-teens over our investment horizon.

Portfolio Activity

During the quarter, we added to our investments in Oracle, Disney and Nike. Meanwhile, strong stock price movement motivated us to trim our investments in Apple, Adobe, Berkshire Hathaway, and TransDigm.

Oracle stock, down -10.75% this quarter, came under pressure after it reported its FQ1 2023 quarterly results. Despite the pullback on rising expectations into the quarterly report, we continue to believe Oracle is well positioned to compound intrinsic value double-digits over our investment horizon as it continues to execute on its pivot to cloud-based solutions. Its OCI Gen 2 solution is particularly well suited for generative AI workloads, where Oracle is gaining mindshare and market share in the hyperscale cloud market. Additionally, for over a decade, ORCL invested heavily to modernize its back-office ERP, supply chain management and HR application suites for the cloud. Those investments are now resulting in market share gains in the strategic back-office application market.

Berkshire Hathaway appreciated +2.73% year to date and continues to enjoy several tailwinds that are sustaining attractive intrinsic value growth. The broad insurance industry is enjoying a period of hardening prices driving solid premium growth and combined ratios despite evidence of social inflation. Berkshire Hathaway's wholly-owned private businesses are benefiting from the strong economy while higher interest rates boost income from their fixed income portfolio. Higher rates also increase the implicit value of low-cost insurance float.

Outlook

Equities head into the final months of 2023 troubled by the possibility of higher-for-longer interest rates tipping the economy into recession. We think investors should avoid predicting recessions, but prepare for economic declines by owning competitively advantaged businesses at prices that compensate for the risk. A combination of durable growth, wide-moat, and compelling valuation improves companies' resilience in recessions. By owning exceptional businesses, we believe our investment outcomes will depend more on business fundamentals than forecasting interest rates or the economy.

Over time, we expect our portfolio's returns to reflect the compounding nature of our businesses and the discount we are paying relative to fair value. Mar Vista does not claim expertise in predicting market direction, but we believe that a patient, high-conviction portfolio of competitively advantaged businesses with appropriately discounted stock prices should generate excess risk-adjusted returns. As we navigate this rapidly evolving investment environment, we will remain disciplined in deploying capital within our wide-moat universe.

Focus Annualized Returns as of September 30, 2023

	<u>Net</u>	<u>S&P 500[®] Index</u>	<u>R1000[®]G Index</u>
1 Year	24.46%	21.62%	27.72%
3 Years	6.84%	10.15%	7.97%
5 Years	9.40%	9.92%	12.42%
10 Years	12.19%	11.91%	14.48%
15 Years	11.59%	11.28%	13.67%
Since Inception	10.71%	10.08%	11.54%

Investors in Mar Vista's Focus strategy acknowledge and agree that (I) any information provided by the Firm is not a recommendation to invest in the strategy and that the Firm is not undertaking to provide any investment advice to the investor (impartial or otherwise), or to give advice to the investor in a fiduciary capacity in connection with an investment in the strategy and, accordingly, no part of any compensation received by the Firm is for the provision of investment advice to the investor and (II) Mar Vista has a financial interest in the investor's investment in the strategy on account of the fees and other compensation the Firm expects to receive from the client.

Mar Vista Investment Partners, LLC, a Delaware limited liability company, is a registered investment adviser under the Investment Advisers Act of 1940. The firm offers investment advisory services to individuals, pension and profit-sharing plans, trusts, estates, corporations, as well as other institutional clients. For purposes of compliance with GIPS[®], Mar Vista has defined itself to include bundled/WRAP fee accounts in the firm's assets. Prior to January 1, 2018, Mar Vista defined itself to not include bundled/wrap fee accounts in the firm's assets. Mar Vista maintains a complete list and description of firm composites, which is available upon request.

On 7/12/07, Silas Myers and Brian Massey formed Mar Vista to manage various large-cap equity strategies. On 12/1/07, all of the assets under their management at Roxbury Capital Management, LLC transitioned to Mar Vista through a sub-advisory arrangement. Information provided for the period from January 2004 through November 2007 represents the performance of portfolios managed by Mr. Myers and Mr. Massey while employed by Roxbury. On 1/25/15, Mar Vista finalized an agreement whereby the preferred share class that was owned by Roxbury was extinguished. All assets under management are managed by Mar Vista. Mar Vista claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of the CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Benchmark returns are not covered by the report of independent verifiers. For the entire period presented, Mr. Myers and Mr. Massey have been substantially responsible for the all the investment decisions of the large-cap equity strategies. Performance prior to 12/01/07 meets GIPS® portability requirements. ACA served as the verifier, conducted a verification and examined the composite's performance history that was ported over to Mar Vista prior to 12/01/07.

The Focus composite was created 12/01/07, with an inception date of 12/31/02. All returns are based in U.S. dollars and are computed using a time-weighted total rate of return. The composite is defined to include all fully discretionary, taxable and tax-exempt portfolios with no minimum or maximum account value, managed in accordance with Mar Vista's Focus strategy, which is a concentrated portfolio invested in 15 to 20 equities, and that paid for execution on a transaction basis. Prior to 4/1/04, the composite was defined to include tax-exempt portfolios with a minimum portfolio value of \$500,000. From 12/31/02 forward, the composite includes portfolios without restrictions and also portfolios with minor restrictions that affect up to a maximum of 5% of the portfolio's value based on the cost of the restricted securities at the time of purchase by other similarly managed portfolios.

The primary benchmark is the Russell 1000® Growth Index, defined as an unmanaged, capitalization weighted index of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. Index returns include dividends and/or interest income and, unlike composite returns, do not reflect fees or expenses. In addition, unlike the composite, which periodically maintains a significant cash position, the Russell 1000® Growth Index is fully invested. Investors cannot directly invest in an index. The secondary benchmark is the S&P 500® Index, defined as an unmanaged, capitalization weighted index of the common stocks of 500 major U.S. corporations. Index returns include dividends and/or interest income and, unlike composite returns, do not reflect fees or expenses. In addition, unlike the composite, which periodically maintains a significant cash position, the S&P 500® Index is fully invested. Investors cannot directly invest in an index.

The dispersion in gross-of-fees composite returns shown herein was measured using an asset-weighted standard deviation formula. Performance results presented reflect the reinvestment of dividends and other earnings. Gross performance is net of all transaction costs, and net performance is net of any transaction costs, applicable performance-based fees and actual management fees, but before any custodial fees. All returns are calculated net of withholding taxes on dividends and interest. Actual results may differ from composite results depending upon the size of the portfolio, investment objectives and restrictions, the amount of transaction and related costs, the inception date of the portfolio and other factors. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. The firm's Strategic Growth fee schedule is as follows: First \$25 million – 0.75%; Next \$25 million - 0.60%; Next \$50 million – 0.50%; Over \$100 million - Negotiable. Special circumstances may cause fees to vary from this schedule and Mar Vista reserves the right to negotiate fees with clients. Fees are payable quarterly in arrears or advance based on 1/4th of the annual rate.

A complete list of portfolio holdings and specific securities transactions for the investment strategy during the preceding 12 months, the top contributors and underperformers calculation methodology and a list of every holding's contribution to the overall performance during the period is available upon request. The sector performance and securities mentioned in this letter were held in the account of a Focus client that Mar Vista believes to be representative of the accounts that Mar Vista manages for this investment strategy during the period from June 30, 2023-September 30, 2023. Other Mar Vista clients managed with different investment objectives may hold different securities than those listed. The securities listed in this letter should not be considered a recommendation to purchase or sell any particular security. The reader should not assume that investments in the specific securities identified herein were or will be profitable. A Focus GIPS® Composite Report is available upon request by contacting Mar Vista directly at (800) 993-1070 or via email at info@marvistainvestments.com. Past performance is no guarantee of future results. Not FDIC insured, no bank guarantee, may lose value.