

## Global

Portfolio Commentary | September 30, 2023

### Summary

- Global 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 Global strategy trailed the MSCI World Index and MSCI ACWI Index during the third quarter.
- The third quarter's top contributors were Alphabet, Intuit and Markel. The top detractors were Pernod Ricard, American Tower, and Apple.
- We built a new position in Danaher and added to our investment in Oracle and Disney during the quarter. Strong stock price movement motivated us to trim our investments in Adobe, Berkshire Hathaway, Markel, Microchip Technology, and TransDigm.
- Equities head into the final months of 2023 troubled by the possibility of higher-for-longer interest rates tipping the global economy into recession.

### Commentary

After a robust first half of 2023, global 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 a global equity market powered by richly valued technology stocks. Excitement around artificial intelligence and signs of subsiding inflation without a recession had propelled equity valuations higher this year.

The outperformance of the seven largest companies, known as the "Magnificent Seven," is unlikely to escape the bond market's gravitational pull much longer. 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.

In China, structural imbalances, such as excess capacity and leverage, especially in the property sector—continue to pose significant constraints on China's growth trajectory. Oil prices surged during the third quarter of 2023, with Brent Crude rising approximately +30% since July. Rising energy prices raise concerns about inflation, which may prompt central bankers to consider additional interest rate hikes.

### Performance Review

Mar Vista's Global strategy declined -5.86% net of fees in the third quarter of 2023. The MSCI World Index and the MSCI ACWI Index returned -3.46% and -3.40%, respectively. Year to date, the portfolio returned +11.68% net of fees versus +11.10% for the MSCI World Index and +10.06% for the MSCI ACWI Index. Stock selection within industrials and consumer staples, along with our lack of energy exposure, negatively impacted performance during the quarter. The third quarter's top contributors were **Alphabet**, **Intuit**, and **Markel**, while **Pernod Ricard**, **American Tower** and **Apple** detracted from results.

**Pernod Ricard** reported respectable performance in fiscal 2023, with organic revenue and earnings growth exceeding our expectations. However, the stock came under pressure in the past quarter after management indicated that the US and China markets are off to a slow start in fiscal 2024. We are not surprised by these comments and expect Pernod, along with the industry, to enter a phase of normalization post the rapid COVID recovery years. Below-trend growth in the US and China markets will pressure our regional forecasts next year, but the impact on Pernod's intrinsic value is immaterial.

We believe the spirits industry slowdown is cyclical rather than structural and normal for the post-pandemic period. Pernod has a broad product portfolio with growing market share around the globe. The company benefits from competitive advantages in the manufacturing and distribution of premium spirits that keep barriers to entry high. As the discount to fair value continues to improve, we will consider increasing our investment.

**American Tower** struggled this quarter in response to the Fed's higher-for-longer interest rate stance pressuring the stock down -15.21% in the quarter. 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.

**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.

Alternatively, **Intuit**, **Alphabet**, and **Markel** were among the portfolio's top contributors for the quarter, appreciating +11.71%, +8.99%, and +6.46%, 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.

**Markel** 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. The wholly-owned private businesses for Markel are benefiting from the strong economy while higher interest rates boost income from the corporation's fixed income portfolios. Higher rates also increase the implicit value of low-cost insurance float.

## Portfolio Activity

During the quarter, we initiated an investment in **Danaher** and added to our investments in **Oracle** and **Disney**. Meanwhile, strong stock price movement motivated us to trim our investments in **Adobe**, **Berkshire Hathaway**, **Markel**, **Microchip Technology** and **TransDigm**.

**Danaher** has long checked three of Mar Vista's qualitative boxes for investment: durable competitive advantages, above average compounding of intrinsic value, and a superior capital allocation strategy. Recently, after material underperformance over the last two years, the fourth criteria were met: stock trades at a discount to our estimate of fair value. This global leader in biotechnology, life sciences, and diagnostics has established strong barriers to entry for each of its businesses. These include a loyal customer base, recurring revenues, and proprietary technology protected by patents and copyrights.

Once Danaher's tools are selected for the clinical trial process of a new drug, they tend to remain in use throughout a successful drug's lifecycle. Moreover, Danaher's well-defined culture, rooted in the Danaher Business System ("DBS"), provides lasting advantages through a focus on continuous innovation, margin expansion, efficient marketing practices, and capital efficiency, all of which have consistently increased shareholder value across a diverse range of businesses.

We anticipate several secular growth trends that will drive high-single-digit revenue and double-digit free cash flow growth over time. While the bioprocessing industry is currently undergoing a temporary adjustment following the COVID-era boom, a secular shift towards biologics and genomics in medicine is expected to significantly expand Danaher's market opportunities. The continued innovation and adoption of molecular diagnostics, the demand for faster and more accurate test results, and a growing installed customer base should fuel strong demand for Danaher's diagnostic products.

Danaher's well-defined capital allocation strategy is poised to further accelerate intrinsic value growth. The company has a proven track record of acquiring assets, optimizing their returns on capital through the DBS process, and often divesting these assets to benefit shareholders. The spinoff of Veralto, Danaher's water quality and product quality/innovation division, will reshape the company's revenue mix. Biopharmaceutical manufacturing tools will account for almost one-third of revenues post-spinoff.

Challenges such as excess inventory from the COVID-era boom, reduced biotech funding, delays in gene and cell-based therapies, and softer demand from China have all pressured Danaher's fundamentals and stock price since late 2021. However, we view these headwinds as primarily cyclical rather than secular, and we anticipate growth to regain momentum in the coming year. Given the stock's nearly one-third decline over the past two years and its modest discount to estimated fair value, we established a new position in our portfolio.

## Outlook

Global equities head into the final months of 2023 troubled by the possibility of higher-for-longer interest rates tipping multiple economies 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.

**Global Annualized Returns as of September 30, 2023**

	<u>Net</u>	<u>MSCI World®</u>	<u>MSCI ACWI®</u>
<b>1 Year</b>	22.06%	21.95%	20.81%
<b>3 Years</b>	2.73%	8.08%	6.89%
<b>5 Years</b>	6.63%	7.26%	6.46%
<b>10 Years</b>	7.96%	8.26%	7.56%
<b>Since Inception</b>	9.29%	9.82%	9.00%

*Investors in Mar Vista's Global 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. 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. On 1/20/15, 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 all the investment decisions of the Global Equity strategy.

The Global Equity composite was created in 2012, with an inception date of 12/31/11. 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 for at least one month in accordance with Mar Vista's Global Equity strategy, which is a portfolio invested in 20-30 equities, and that paid for execution on a transaction basis. The results in the column marked net of fees for the periods 1/01/12 through the present, include a standard management fee applied to any non-fee-paying portfolio for performance calculation purposes.

The primary benchmark is the MSCI World (Net) Index, defined as a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index consists of the following 23 developed market country indexes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States. In addition, unlike the composite, which periodically maintains a cash position, the MSCI World Index is fully invested. Investors cannot directly invest in an index.

The secondary benchmark is the MSCI ACWI (Net) Index, defined as a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging market country indices. In addition, unlike the composite, which periodically maintains a cash position, the MSCI ACWI Index is fully invested. Investors cannot directly invest in an index. The dispersion in gross-of-fee 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 GIPS® Composite Reports are available upon request.

The Firm's Global Equity 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 Global Equity 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 Global Equity GIPS® Composite Report is available upon request by contacting Mar Vista directly at (800) 993-1070 or via email at [info@marvistainvestments.com](mailto:info@marvistainvestments.com). Past performance is no guarantee of future results. Not FDIC insured, no bank guarantee, may lose value.