MAR VISTA

Global

Portfolio Commentary | March 31, 2024

Summary

- Global markets had their best first-quarter performance in five years. Resilient corporate profits, enthusiasm around AI and expectations for interest rate cuts drove stock prices higher.

- Everything from stocks to bitcoin to gold marched higher. The AI boom has fueled the market's gains, with chip designer Nvidia adding more than $1 trillion in market value after rising 82% during the first three months of the year. Nvidia's appreciation is equivalent to about one-fifth of the total gain for global stock markets over that period.

- Mar Vista's Global strategy returned +6.52% net-of-fees in the first quarter of 2024. The MSCI World Net Index and the MSCI All Country World Net Index returned +8.85% and +8.14%, respectively. Stock selection within information technology, consumer staples, and real estate negatively impacted performance during the quarter.

- The first quarter's top contributors were Walt Disney, TransDigm, and Amazon. The top detractors were Adobe, GXO Logistics, and Apple.

- We established a new investment in Novonesis and added capital to Adobe, Alphabet, Nestle and Unilever. Lower conviction in Honeywell and Reckitt Benckiser prompted investment liquidations.

- The stock market's early surge surpassed even optimistic predictions. The tech-driven rally gradually broadened out across the quarter, with equities in Europe and Japan beginning to outpace the US. Historically, strong first quarters often translate to positive years, making the current situation promising.

Commentary

Global markets had their best first-quarter performance in five years. Resilient corporate profits, enthusiasm around AI and expectations for interest rate cuts drove stock prices higher. The global economy continues to defy expectations and recession worries have weakened.

In a broad market rally, everything from stocks to bitcoin to gold marched higher. The AI boom has fueled the market's gains, with chip designer Nvidia adding more than $1 trillion in market value after rising 82% during the first three months of the year. Nvidia's appreciation is equivalent to about one-fifth of the total gain for global stock markets over that period.

A Goldilocks economy underpins equity markets. Consumers are spending on services and unemployment remains favorable. Investor sentiment remains optimistic and monetary policy is turning more positive. Solid corporate fundamentals are expected to translate into another quarter of earnings growth, suggesting that the global equity rally has room to run.

Performance Review

Mar Vista's Global strategy returned +6.52% net-of-fees in the first quarter of 2024. The MSCI World Net Index and the MSCI All Country World Net Index returned +8.85% and +8.14%, respectively. Stock selection within information technology, consumer staples and real estate negatively impacted performance during the quarter. **Walt Disney, TransDigm** and **Amazon** were among the portfolio's top contributors for the quarter, appreciating +35.52%, +21.75%, and +18.72%, respectively. Alternatively, our investments in **Adobe** (-15.4%), **GXO Logistics** (-12.1%), and **Apple** (-10.82%) were among the portfolio's biggest detractors.

Walt Disney's latest financial results showcased significant progress, leading to an increase in stock price. The most noteworthy factor was the improved performance of its streaming business. With media profitability recovering, management is optimistically guiding for 20% earnings growth in 2024. This positive outlook is also supported by lower costs and strong performance from its parks division.

Walt Disney's streaming service is on track to become profitable by its fiscal fourth quarter. This aligns with our original investment thesis, which expected the direct-to-consumer (DTC) business to move from a loss of $2 billion to a profit of $1 billion. Even after the recent stock price increase, Walt Disney remains undervalued relative to Netflix. We expect this gap to shrink as its streaming business matures and becomes increasingly profitable over the next few years.

TransDigm delivered another impressive quarter, exceeding analyst expectations on both earnings and profitability. Its gross and EBITDA margins widened significantly, driven by strong performances in commercial aerospace and defense. Revenue growth in commercial aerospace aftermarket parts (+27%) and new defense orders were key contributors to this outperformance. Management responded by raising full-year 2024 forecasts for revenue and profitability.

Continued growth in both defense and commercial aftermarket should be fueled by recovering passenger traffic, higher aircraft utilization, and a strong bookings backlog. With domestic travel exceeding pre-pandemic levels and international travel nearing full recovery, TransDigm appears well-positioned for continuous growth. This, combined with its efficient operations, should drive long-term stock price appreciation.

Amazon is experiencing a surge in profitability, reflected in significantly higher retail profit margins. Strategic cost reductions in headcount and fulfillment have materialized into financial gains. While the unexpected pandemic-driven demand surge necessitated a rapid expansion of fulfillment infrastructure, this initially impacted operating profits. However, current unit sales growth has effectively reached equilibrium with fulfillment capacity. This balance is leading to positive adjustments to both earnings and intrinsic value estimates. Should the economic climate continue to improve, we believe Amazon's investment potential aligns with its projected 15-20% intrinsic value growth trajectory.

Despite underperforming during the quarter, **Adobe** remains a powerful player in the creative professional market. We believe the company is well-positioned to capitalize on two key trends: the ongoing shift towards digital commerce and the rise of generative AI.

Adobe stands out as an early leader in generative AI, offering both standalone solutions like Firefly and integrated features within established products like Photoshop. This puts them ahead of the curve, attracting both creative professionals and marketing teams within corporations. As a result, Adobe is experiencing strong bookings growth in the mid-teens, which ultimately translates to healthy revenue, earnings, and cash flow. Based on these factors, we project continued intrinsic value growth for Adobe in the low-to-mid-teens range over our investment horizon.

GXO Logistics experienced a setback this quarter. Customer volumes dropped 9%, stalling any organic growth. This slump was primarily driven by weakness in the omnichannel retail and consumer packaging sectors. As a result, the company's 2024 forecasts fell short of analyst expectations, leading to a drop in share price after the announcement.

Despite cyclical headwinds, there are signs of a turnaround for GXO. Management indicated that customer volumes in January have already begun to improve. Additionally, they expect easier comparisons in the latter half of 2024 to further aid recovery. To us, this suggests that the first half of 2024 may be the cyclical low point, with a rebound on the horizon. Over the next few quarters, GXO should get back on track towards achieving its long-term financial goals.

Apple's stock was pressured in the quarter as investors fretted over softening demand for smartphones, regulatory action from the US Department of Justice, and the Chinese government mandates restricting iPhone use by government officials. Despite these near-term headwinds, we continue to believe the company remains competitively advantaged and benefits from the Apple ecosystem, which has an installed base of over 2 billion devices and over 1 billion paying subscribers. We believe the Apple ecosystem will support a more predictable cash flow stream, which should grow intrinsic value high-single-digits over our investment horizon.

Portfolio Activity

During the quarter, we initiated an investment in Novonesis and added capital to Adobe, Alphabet, Nestle and Unilever. Lower conviction in Honeywell and Reckitt Benckiser prompted investment liquidations.

Novonesis is the new name for the recently merged Novozymes and Chr. Hansen. The combined company is a dominant leader in biosolutions, notably enzymes and cultures, for more than thirty different industries and wields a broad biological toolbox to develop innovative solutions across various domains. Half of Novonesis' portfolio focuses on enabling better lives and foods while the other half is dedicated to a better environment such as reducing chemical use and promoting climate-neutral practices. The company enjoys durable competitive advantages due to switching costs, intellectual property, and scale advantages. We project revenues will grow mid-to-high single digits on the strength of innovation, secular demand for safer, cleaner solutions and improved pricing power. Returns on invested capital should march higher as stronger revenue growth and operating leverage drive double-digit profit growth.

After nearly 14 years of owning shares in **Honeywell**, we decided to sell our investment during the quarter. This decision was based on a combination of issues that threatened our investment thesis for the company. The main challenges were related to organic growth and capital deployment. Specifically, we have concerns about Honeywell's future organic growth and its indecisive approach to capital deployment. Even with a strong balance sheet, cash surplus, and low leverage, its capital deployment process lacks direction. Additionally, Honeywell is heavily invested in cyclical and short-cycle businesses which can be volatile. For these reasons, we sold our investment in Honeywell.

Reckitt Benckiser (RB) boasts a strong brand portfolio, but recent performance has been underwhelming. The company's strategic shift towards high-margin health and hygiene products has streamlined operations. However, execution issues are hindering growth, and the company's financial guidance is overly optimistic compared to actual results. We think RB might be underestimating operational challenges.

While RB claims to have maintained pandemic gains, true product volumes have not improved once inflation is considered. With RB facing a period of lower structural growth, we reallocated capital to faster compounding businesses. Fortunately, we exited before legal issues materialized in RB's infant nutrition segment.

Outlook

Many investors entered 2024 with high hopes, buoyed by the previous year's gains in technology stocks. Yet, the stock market's early surge surpassed even optimistic predictions. The tech-driven rally gradually broadened out across the quarter, with equities in Europe and Japan beginning to outpace the US. Historically, strong first quarters for global equites often translate to positive years, making the current situation promising.

While valuations are currently above historical averages, a strong underlying global economy continues to fuel market momentum. However, remaining vigilant against potential risks like persistent inflation or disappointing earnings is crucial.

As long-term investors, we favor businesses exposed to secular trends that will shape the next decade. Our portfolio prioritizes moated companies with strong financials, positioning them to excel in the current environment. Even though the market anticipates a controllable economic slowdown, we believe our holdings hold significant potential for outperformance.

Through patient investment in high-conviction companies and disciplined capital allocation, we aim to deliver favorable risk-adjusted returns over time. We believe this strategy will allow our portfolio to benefit from both the intrinsic value growth of our holdings and the attractive entry points we secured.

Global Equity Annualized Returns as of March 31, 2024

	Net	MSCI World Net Index	MSCI All Country World Net Index
1 Year	20.12%	25.07%	23.16%
3 Years	6.51%	8.59%	6.94%
5 Years	9.88%	12.07%	10.91%
10 Years	9.01%	9.39%	8.66%
Since Inception	10.41%	11.14%	10.26%

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 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 December 31, 2023-March 31, 2024. 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. Past performance is no guarantee of future results. Not FDIC insured, no bank guarantee, may lose value.