MAR VISTA

Strategic Growth

Portfolio Commentary | September 30, 2024

Summary

- The third quarter of 2024 marked another strong period for the U.S. stock market, with the S&P 500® Index rising for the fourth consecutive quarter - a feat not seen since Q4 2021. The S&P 500® Index is off to the best performance in the first three quarters of a year since 1997.

- Market sectors including utilities, real estate, industrials, and financials outperformed the technology sector, which had been driving much of the market's gains earlier in the year.

- Mar Vista's Strategic Growth strategy returned +5.49% net-of-fees in the third quarter of 2024. The Russell 1000® Growth Index and the S&P 500® Index returned +3.19% and +5.89%, respectively.

- The third quarter's top portfolio contributors were American Tower, TransDigm, and Apple. The top detractors were Alphabet, Microchip Technology, and Microsoft.

- During the quarter, we initiated new investments in AMETEK, Stryker, and Unilever. We completely liquidated our investments in Fortive and Nike.

- The market appears to be at the beginning of an easing cycle, with interest rates not exceptionally high by historical standards, which could support further gains. Years with strong starts like this have often finished even higher, with the S&P 500® Index typically ending the year on a high note after such robust performance in the first nine months.

Commentary

The third quarter of 2024 marked another strong period for the U.S. stock market, with the S&P 500® Index rising for the fourth consecutive quarter - a feat not seen since Q4 2021. Year-to-date, the index has surged over 22% through the first nine months, an achievement occurring only for the 10th time since 1950. The S&P 500® Index is off to the best performance in the first three quarters of a year since 1997.[1]

Interestingly, this quarter saw a shift in sector performance. Utilities emerged as the top-performing sector in the S&P 500®Index, gaining 18%, closely followed by real estate with a 16% increase.

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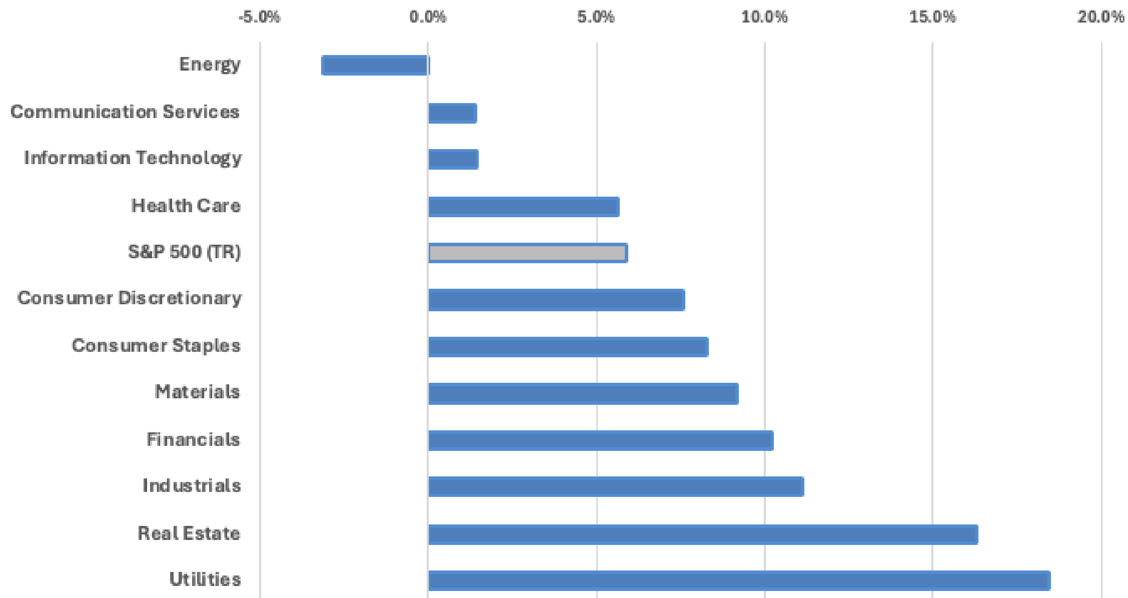
[1] Source: Karen Langley, "The Stock Market Isn't All About AI Anymore," Wall Street Journal, 9/30/24



Broad market sectors including industrials and financials outperformed the technology sector, which had been driving much of the market's gains earlier in the year. Value stocks beat growth stocks, and small-cap stocks outperformed their large-cap counterparts.

The tech sector, particularly the "Magnificent Seven" stocks, showed mixed performance. Nvidia, Alphabet, Microsoft, and Amazon pulled back after strong first-half gains, while Apple, Meta Platforms, and Tesla ended the quarter higher. This divergence likely reflected growing investor skepticism about the heavy AI spending by big tech companies, with the market entering what some analysts describe as a "zone of disillusionment," reminiscent of the internet boom in 2000.

Several economic factors contributed to the market's performance. Weaker inflation readings led the Federal Reserve to lower interest rates, and signs of economic strength increased confidence in a "soft landing" scenario. The U.S. economy showed continued expansion, with low unemployment. Corporate earnings remained robust and are expected to accelerate into 2025.

Performance Review

Mar Vista's Strategic Growth strategy returned +5.49% net-of-fees in the third quarter of 2024. The Russell 1000® Growth Index and the S&P 500® Index returned +3.19% and +5.89%, respectively. Stock selection within materials, consumer discretionary and financials negatively impacted our performance during the quarter. **American Tower**, **TransDigm**, and **Apple** were among the portfolio's top contributors for the quarter, appreciating +19.6%, +11.7%, and +10.7%, respectively. Alternatively, our investments in **Alphabet** (-8.7%), **Microchip Technology** (-11.7%), and **Microsoft** (-3.5%) were among the portfolio's biggest detractors.

American Tower's stock rebounded nearly 20% during the third quarter, helped by the tailwind of lower interest rates. The stock has now appreciated more than one-third since U.S. 10-Yr Treasury interest rates peaked in late April 2024. As a levered REIT, lower rates benefit AMT's equity value through a lower cost of debt and a higher value for its long-duration cash flows. Fundamental expectations did not change materially during the quarter as the company modestly increased their growth expectations for the year. The long-term global opportunities for 5G deployment, edge-of-network computing, and datacenters, remain attractive and are not fully reflected in the current stock price, in our opinion.

TransDigm reported another earnings beat-and-raise during its fiscal third quarter as it continues to benefit from a surge in global travel, surpassing pre-pandemic levels. The airlines posted no significant change in aircraft order or delivery patterns despite overcapacity issues. Both Boeing and Airbus remain in a holding pattern on producing and delivering new units due to manufacturing quality and labor issues (strike) in the case of Boeing and supply chain challenges in the case of Airbus. This plays directly into the hands of TransDigm's most profitable business, commercial aerospace aftermarket, as load factors remain high, and take-offs and landings continue to grow beyond pre-pandemic levels. Moreover, the company announced a significant special dividend to be paid in October 2024. Even with this payment, TransDigm has over $5.5 billion of capital to execute its acquisition strategy in what should be a robust M&A market in 2025.

Apple stock was strong in the quarter as investors viewed the company's generative AI roadmap and iPhone 16 product cycle positively. The market was reminded of the strength of the Apple ecosystem as management demonstrated how generative AI solutions would be integrated into its iOS 18 operating system, which was broadly released in the iPhone 16 late in calendar Q3. We believe Apple's generative AI-enabled products should spur a meaningful iPhone upgrade cycle and create new avenues of monetization through its app store and advertising offerings. We believe this will support intrinsic value growth that will range between high single digits and low double-digits over our investment horizon.

Alphabet recently lost an antitrust lawsuit related to its estimated $20 billion annual distribution agreement with Apple and other smartphone and web platforms. This legal setback negatively impacted Alphabet's stock price during the quarter. We anticipate significant uncertainty in the coming year as concerns about potential remedies cast a shadow over its lucrative search business. Despite this, we remain optimistic about Alphabet's overall business strength and ability to maintain leadership in various industries including search, artificial intelligence, video, and cloud computing. While we believe Alphabet is undervalued, we are exercising incremental caution due to the current legal challenges.

Microchip's stock was pressured in Q3 as the company continued to experience demand pressures due to a cyclical inventory correction in its end markets of microcontrollers and analog components. During the pandemic, microcontrollers and analog devices were difficult to secure and created bottlenecks in supply chains for broad-based industrial and automotive customers. This led to double ordering from direct and indirect customers, which ultimately resulted in a buildup of excess inventory. Microchip is working through this inventory correction, and it has shipped below end-demand for almost a year, in our opinion. We continue to believe that Microchip is well-positioned to grow intrinsic value double-digits once inventory in the channel clears. We believe this should likely occur exiting 2024 or in the first part of 2025.

Microsoft stock was pressured in the quarter as investors fretted over rising capex as Microsoft invests heavily in the burgeoning generative AI market. Investors are concerned about the rising capital intensity of the business and the uncertain return on that investment. We continue to believe that Microsoft occupies a strong competitive and strategic position and that it is poised to capture market share as

businesses, both large and small, navigate the transition to a digital-first landscape and embrace generative AI-driven productivity tools. 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 by offering a roadmap for digital transformation and adoption of cutting-edge, AI-driven solutions, such as ChatGPT and its suite of Copilot applications, which enhance productivity and reduce 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.

Portfolio Activity

During the quarter, we initiated new investments in **AMETEK**, **Stryker**, and **Unilever**. We completely liquidated our investments in **Fortive** and **Nike**.

AMETEK is an acquisition and growth compounder in the multi-industrial industry. Management believes the company can achieve double-digit earnings growth over a cycle by focusing on niche markets in its 42 business units. The company competes in diverse markets and has reduced cyclicality significantly across all its business units. A result of these efforts is structurally improved organic growth and a consistent, repeatable, and successful acquisition strategy. AMETEK is a low capital intensity business with a strong merger pipeline. The declining interest rate environment should bolster its acquisition efforts.

After researching AMETEK for years, we opportunistically purchased the company after the stock declined on its second quarter earnings report. Like many industrial and materials companies, AMETEK has been victimized by inventory destocking, as well as project delays at the customer level that were expected to be contained in the first half of 2024. Management now expects these transitory trends to last through year end and improve in 2025. We believe this realistic outcome was adequately discounted in our purchase price.

Our investment thesis for **Stryker** focuses on its durable economic moat in orthopedics, innovation across its product platform, operating margin expansion, and shareholder value-accretive acquisition strategy. We believe intrinsic value can compound 11-13% over our five-year time horizon, which should approximate the stock's appreciation during that period.

The barriers for orthopedic substitutes should remain high and market shares sticky, as doctors, trained on one platform early in their careers are unlikely to switch brands. The industry has naturally evolved into an oligopoly with Stryker, Johnson & Johnson, and Zimmer Biomet accounting for two-thirds of the market. Under-scaled competitors are further hindered by hospitals' desire to manage fewer vendor relationships.

We expect 4-7% long term growth in Stryker's Orthopedics/Spine segment (42% of revenue), which includes hips, knees, extremities, trauma and spine. Additionally, expanding adoption of the Mako Robot in hips, knees, shoulders and spine should widen competitive advantages in Ortho and provide a tailwind across the Stryker portfolio.

In the higher growth MedSurg/Neurotechnology segment (56% of revenue), Stryker's dominant share (50% in Orthopedic Instruments, 30% in Medical, 18% in Endoscopy, 40% in Neurotechnology) and innovation will be the keys to faster 7-8% revenue growth. The company is enjoying a "super cycle" of

product innovation. The LIFEPAK 35 defibrillator, 1788 camera, and System 9 power tools, among others, should drive multi-year share gains. Stryker is also reinvesting and developing scale in international markets (27% of revenue) as the company is under-indexed relative to competitors.

We expect operating margins to expand 100 basis points ("bps") in 2025 as cost pressures from the last few years abate. Over the longer term, steady revenue growth, lower cost manufacturing, and modest price increases should drive roughly 30bps of annual margin expansion.

Moreover, Stryker's capital allocation strategy has created value over recent years. Mid-sized acquisitions have generated new and faster growth platforms (Vocera's digital care coordination and communication embeds Stryker deeper into hospital operations), broader scale (PhysioControl and Wright Medical), faster innovation, and improved shareholder value growth. With nearly 50% returns on tangible invested capital, Stryker enjoys a favorable spread versus the cost of capital. Acquisitions over the last five years have compressed total ROIC to low teens, but we expect steady expansion as 30% incremental operating margins and low capex requirements (3-4% of revenue) drive higher returns. The dividend payout ratio should remain 25-30% with minimal share repurchases.

Stryker's well-articulated culture and stable leadership (only 3 CEOs since 1977) should be key differentiators in managers thinking like owners, exploiting long-term opportunities, and avoiding aggressive value-destroying strategies.

We resumed our investment in **Unilever.** We divested our Unilever position in 2022, following the company's failed attempt to acquire GlaxoSmithKline's (GSK) consumer health business. That proposed deal, characterized by its exorbitant price tag and a strategic shift from incremental to transformative acquisitions, eroded our confidence in Unilever's capital allocation capabilities. The strategic misstep, coupled with a shareholder revolt and a negative stock price reaction, ultimately led management to abandon the acquisition.

Since our departure, Unilever has hired a new CEO and demonstrated a renewed commitment to enhancing shareholder value through a more disciplined approach to acquisitions and divestitures. Trian's involvement in Unilever, including their investment and Nelson Peltz's board position, has positively impacted the company's capital allocation strategy.

Unilever's wide economic moat and substantial emerging market scale provide a strong foundation for value creation. We believe that the new capital allocation team should accelerate intrinsic value growth by rationalizing the product portfolio through food divestments and strategic acquisitions in high-growth personal care categories. While current economic conditions may obscure the company's progress, we are encouraged by the early signs of a successful turnaround. We consider our re-entry price to offer an attractive discount relative to the intrinsic value of Unilever's strong brand portfolio.

Fortive was sold during the quarter for violating our investment criteria. The company had been plagued by an inability to forecast their business fundamentals, which lead to chronic under achievement of quarterly revenue and earnings expectations. The second quarter was the final earnings report within our provisional timeline for the company to cure the issues and show progress. After failing to deliver on our financial expectations, we sold the shares.

We exited our **Nike** investment following an 18% stock price recovery from recent lows. This decision was prompted by Nike's revised fiscal year 2025 forecast, which projects negative mid-single-digit revenue

growth. The company faces a significant slowdown in lifestyle product sales, expected to persist for at least another year. Our analysis indicates sales and earnings will likely fall 15-20% below management's previous conservative estimates. This downward revision stems from insufficient product innovation, wholesale channel shifts, and intentional supply reduction in lifestyle franchises. While reduced guidance and new leadership might provide a catalyst for the stock's performance, the path to fundamental improvement is still unclear.

Despite maintaining its position as the global sportswear leader, Nike's intrinsic value has stagnated. The company's efforts to reinvigorate innovation and re-engage with wholesale channels may eventually yield growth, but our skepticism regarding management's execution has increased. We believe Nike needs to reset investors' expectations on margins and profits while revitalizing its top-line prospects. A short-term profit sacrifice, though painful, could provide the necessary reset to achieve financial expectations in future years. We will continue monitoring Nike's turnaround and reassess the investment if fundamentals and management execution improve.

Outlook

Looking ahead, historical trends paint an optimistic picture for the remainder of 2024. Years with strong starts like this have often finished with the S&P 500® Index typically ending the year on a high note. In fact, since 1950, only once - during the 1987 crash - has the index fared significantly worse by year-end following such a strong initial showing. The market's proven resilience offers hope for continued strength, but investors should understand that economic soft landings are typically uncommon.

The market appears to be at the beginning of an easing cycle, with interest rates not exceptionally high by historical standards, which could support further gains. As equities move into the final quarter of 2024, we are monitoring signs of continued economic resilience and AI's impact on corporate profitability. The economy's strength could support a continued rally across various industries, particularly given the Federal Reserve's successful implementation of a soft landing and the broadening of the market beyond the "Magnificent Seven". Despite the potential for an expanding earnings recovery, we remain vigilant about risk allocation. With a significant market correction seemingly less likely given the easing monetary conditions, the rally may be somewhat overstated.

Prudent investment strategies should balance the opportunities presented by AI's technological innovation with a long-term, value-accretive philosophy. This approach can help navigate current market dynamics, positioning portfolios to benefit from enduring market trends while maintaining resilience against unrealized risks. Our investment approach is focused on businesses with strong competitive moats that can compound intrinsic value across various economic conditions.

Notice

Mar Vista is pleased to announce that, effective January 1, 2025, our Strategic Growth portfolio will be renamed U.S. Quality. This rebranding is designed to more accurately reflect the portfolio's underlying investments and align with evolving marketplace terminology. The investment team, management, and portfolio objectives will remain unchanged, as will our commitment to delivering long-term value to our investors.

Strategic Growth Annualized Returns as of September 30, 2024

	Net of Fees	S&P 500® Index	R1000®G Index
1 Year	28.59%	36.34%	42.19%
3 Years	6.65%	11.91%	12.02%
5 Years	12.71%	15.98%	19.74%
10 Years	12.29%	13.38%	16.52%
Since Inception	10.31%	10.38%	12.04%

Investors in Mar Vista's Strategic Growth 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 Capital Management. 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 Strategic Growth Composite was created 12/01/07, with an inception date of 12/31/03. 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 portfolios with no minimum or maximum account value, managed in accordance with Mar Vista's Strategic Growth strategy, and that paid for execution on a transaction basis. Prior to 1/01/06, the composite was defined to include only taxable portfolios with no minimum or maximum value. The results in the column marked Net of Fees for the periods 8/01/08 through the present, include a standard management fee applied to any non-fee-paying portfolio for performance calculation purposes.

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 Strategic Growth 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, 2024-September 30, 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 Strategic Growth 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.