

MAR VISTA

Strategic Growth

Portfolio Commentary | March 31, 2024

Summary

- The S&P 500® Index (“S&P 500®”) had its best first-quarter performance since 2019. 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. Over half of the S&P 500® companies hit new 52-week highs, with AI-related firms leading the charge. Nvidia's stock price surged over 82%, adding more than \$1 trillion to its market value in the first quarter.
- Mar Vista's Strategic Growth strategy returned +6.68% net-of-fees in the first quarter of 2024. The Russell 1000® Growth Index and the S&P 500® Index returned +11.41% and +10.56%, respectively.
- The first quarter's top contributors were Walt Disney, TransDigm, and Amazon. The top detractors were Adobe, Nike, and GXO Logistics.
- We established a new investment in Equifax and added capital to Adobe, Amazon, Danaher, Johnson & Johnson, Mettler-Toledo, and Starbucks. Apple's robust performance over the years led to a modest trim, while lower conviction in GXO Logistics and Honeywell prompted an investment reduction and liquidation, respectively.
- The stock market's early surge surpassed even optimistic predictions. Historically, strong first quarters for the S&P 500® often translate to positive years, making the current situation promising.

Commentary

The first-quarter performance of the S&P 500® was its best since 2019. Resilient corporate profits, enthusiasm around AI and expectations for interest rate cuts drove stock prices higher. The economy continues to defy expectations and recession worries have weakened.

In a broad market rally, everything from stocks to bitcoin, and even gold, saw significant gains. Over half of the S&P 500® companies reached new 52-week highs, with artificial intelligence (AI)-related firms leading the surge. Nvidia, a frontrunner in developing AI chips, is a prime example of this trend. Nvidia's stock price soared over 82%, adding more than \$1 trillion to its market value in the first quarter. This gain represents roughly one-fifth of the total gains for the global stock market during that period.

A Goldilocks economy underpins equity markets. Consumers are spending and unemployment remains below 4%. Investor sentiment remains optimistic and monetary policy is turning more favorable. Solid corporate fundamentals are expected to translate into a third consecutive quarter of earnings growth for S&P 500® companies. Analysts project a healthy 11% increase in S&P 500® profits for the entire year, suggesting that the stock market rally has room to run.

Performance Review

Mar Vista's Strategic Growth strategy returned +6.68% net-of-fees in the first quarter of 2024. The Russell 1000® Growth Index and the S&P 500® Index returned +11.41% and +10.56%, respectively. Stock selection within information technology, industrials, and healthcare negatively impacted our 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%), **Nike** (-13.1%), and **GXO Logistics** (-12.1%) 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.

Nike's recent earnings report was a mixed bag. While revenue met expectations and earnings exceeded them, the stock price dipped due to management's cautious outlook for fiscal 2025. The company is currently undergoing a period of internal restructuring and product line adjustments, which is expected to lead to flat revenue growth in the first half of the coming fiscal year. However, this transition aims to position Nike for long-term success.

Our conviction in Nike remains high, and we expect it to emerge stronger and more competitive once the restructuring is complete despite the softer revenue forecast. Nike still anticipates earnings will grow around 10% in calendar 2024 and will accelerate to 15% in 2025 as execution normalizes.

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.

Portfolio Activity

During the quarter, we initiated an investment in **Equifax** and added capital to **Adobe, Amazon, Danaher, Johnson & Johnson, Mettler-Toledo, and Starbucks**. **Apple's** robust performance led to a modest trim, while lower conviction in **GXO Logistics** and **Honeywell** prompted a trim and liquidation, respectively.

Equifax (EFX) is a frontrunner in both credit reporting and income/employment verification. These data-driven businesses require minimal physical assets and boast high barriers to entry due to their established infrastructure. This, combined with the fixed cost structure of the industry, allows EFX to leverage its operations efficiently and see increasing returns on capital.

Even though the credit bureau market is well-developed, EFX actively invests in new products, expands globally, and makes strategic acquisitions. These efforts broaden its addressable market and, in our view, will lead to growth exceeding industry averages. EFX's Workforce Solutions, their largest and fastest-growing segment, holds a unique and comprehensive dataset of approximately 125 million non-farm payroll records. The company is expanding this service to address several end markets including mortgage, credit cards, auto loans, government services, and employee background checks. With EFX's leadership position, market expansion opportunities, and an anticipated return to normalcy in the mortgage market, we project intrinsic value to compound 20% annually over our investment timeline.

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.

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. Historically, strong first quarters for the S&P 500® often translate to positive years, making the current situation promising.

While valuations are currently above historical averages, a strong underlying 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.

Strategic Growth Annualized Returns as of March 31, 2024

	Net	S&P 500® Index	R1000®G Index
1 Year	24.88%	29.87%	38.99%
3 Years	7.47%	11.49%	12.50%
5 Years	12.64%	15.05%	18.52%
10 Years	12.19%	12.96%	15.98%
Since Inception	10.16%	10.11%	11.74%

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 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 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.