JENSEN
INVESTMENT MANAGEMENT

TRANSCRIPT
OCTOBER 2024

Quality Mid Cap Fund Quarterly Update: 3Q 2024

Hosted by Kurt Havnaer, CFA, Portfolio Manager

KURT HAVNAER: My name is Kurt Havnaer. I'm one of the portfolio managers on the Jensen Quality Mid Cap Fund. I'd like to welcome you to our webinar for the third quarter of 2024.

Here is our agenda for today's webinar. We will begin by reviewing the Fund's performance and some of the changes we made to the portfolio during the quarter. We will then provide our outlook for the markets and the economy.

Before jumping into performance, we would like to provide a brief overview of Jensen and our philosophy for the Mid Cap Strategy. Jensen was founded in 1988. The firm is owned by approximately half of our current employees. We manage $12 billion in assets in three primary investment strategies: Jensen Quality Growth, Jensen Quality Mid Cap and Jensen Global Quality Growth.

In terms of our philosophy for the Mid Cap Strategy, we believe that undervalued stocks of high-quality companies represent attractive investment opportunities. We define a high-quality company as one with strong competitive advantages. If a company has strong competitive advantages, that should enable it to generate high returns on capital. And if a company's returns on capital exceed its cost of capital, that's what drives the value of the business higher in the future.

Moving on to performance, slide 5 shows the Fund's net returns over various time periods through September 30, 2024. As you can see, the Fund outperformed its primary benchmark, the Russell Midcap Index, during the third quarter and over the past three and five years. With a return of approximately 28%, the Fund underperformed its benchmark by approximately 100 basis points over the past 12 months.

The next slide compares the Fund's gross returns for the third quarter to the Russell Midcap Index. As shown in the last row of the table on the left, the Fund's gross return of 11.19% outpaced the Midcap Index, which was up 9.27%. From a sector standpoint, the Fund's underweight in Energy and overweight

Listen to the webinar at:
www.jenseninvestment.com

Questions? Contact us:
clientservices@jenseninvestment.com
800.221.4384

in Industrials were the two largest sector contributors to relative performance. Our underweights in Real Estate, Utilities and Financials and overweight in Consumer Staples were the largest sector detractors from relative performance.

On the right-hand side of the slide, you can see the top five individual stock contributors to and detractors from relative performance. We would like to provide some color on both Crown Holdings and Gentex on the next two slides.

As indicated on the previous slide, CCK, or Crown Holdings, was the largest individual stock contributor to performance during the quarter. Crown is one of the largest aluminum beverage can producers in the world. The company also manufactures food and aerosol cans, as well as straps and films that are used to protect cargo loads during transportation. We believe the stock outperformed due to the company raising earnings guidance for the current fiscal year and the company reporting strong volume growth in North America and Brazil in its most recent quarter. Crown remains a core holding in the portfolio due to the stock's attractive valuation, the company's strong market position, the company's high customer switching costs and entry barriers, and our expectations that aluminum cans will continue to gain share versus glass and plastic containers due to aluminum's superior environmental profile.

Gentex was the Fund's largest individual stock detractor from performance during the quarter. Gentex is the tier one supplier of automatic dimming rearview mirrors to automobile manufacturers around the world. We believe the stock underperformed due to the slowdown in global light vehicle production. Despite this slowdown, we remain confident in the company's long-term prospects due to its strong innovation track record, dominant global market share, significant economies of scale versus smaller competitors and high customer switching costs. We also believe the company's stock is attractively priced.

In terms of portfolio changes during the quarter, we purchased Clorox and liquidated positions in Kellanova and Williams-Sonoma. We also reduced our weighting in Lennox meaningfully. Clorox is a well-known producer of household products, including Formula 409, Pine-Sol, Glad Trash Bags, Clorox Disinfecting Wipes and Clorox Bleach. Other brands owned by the company include Hidden Valley and Burt's Bees. We added Clorox to the portfolio due to its well-known brands, solid market positions in niche product categories and the non-cyclical nature of demand for the company's products. We also believe the company's stock is attractively priced.

Kellanova was formed last year when the Kellogg company spun off its North American cereal business. We sold the stock after it increased sharply following rumors and then the official announcement that the company would be acquired by Mars, the privately held producer of M&M's, Snickers and other confectionary products.

Williams-Sonoma, the specialty retailer of home furnishings under the Pottery Barn, West Elm and Williams-Sonoma banners was liquidated primarily for valuation reasons. Similarly, we reduced our weighting in Lennox, an HVAC manufacturer, for valuation reasons. Our investment process incorporates disciplined sell triggers that are based on a combination of the strength of a company's underlying fundamentals and the valuations derived from our valuation models. During the quarter, Lennox stock tripped our sell trigger, which resulted in the weighting reduction.

Moving on to our outlook for the economy and markets, not surprisingly, a number of tailwinds exist that support that outlook. Likewise, a number of headwinds exists that could pressure economic growth and market performance going forward.

In terms of tailwinds, the next two slides indicate that the U.S. labor market remains strong. This strength could lead to solid consumer spending, which, as a reminder, accounts for approximately two-thirds of GDP in the U.S. This graph shows the year-over-year change in monthly average hourly earnings going back to 2007. While hourly earnings growth declined over the past couple of years, it remains above the historical average of 3.1%.

The graph on slide 12 shows the U.S. unemployment rate going back to the late 1940s. At 4.1%, the current unemployment rate remains well below the historical average of 5.7%. The decline in inflation over the past couple of years is arguably another tailwind for the economy and markets. This graph shows the year-over-year change in monthly core personal consumption expenditures, which is the Fed's preferred measure of inflation. This data goes back to 2003. While still above the long-term historical average of 2.1%, inflation declined significantly since its most recent peak.

Slide 14 shows the difference between the yield on 10-year and 2-year Treasury bonds on a weekly basis going back to 2014. Historically, an inverted yield curve — when long rates are lower than short rates — has been a good predictor of recessions. This graph shows that the yield curve was inverted for approximately two years, but the economy did not fall into a recession during this time period. Recently, the yield curve turned positive, suggesting that bond investors do not foresee a recession in the near term.

Another tailwind is the expected improvement in corporate earnings. Slide 15 shows that earnings growth for companies in the S&P 500 is expected to pick up this year and next following weakness in 2022 and 2023.

In terms of headwinds, the strong rally that began in the fourth quarter of last year appears to have pushed equity valuations to relatively expensive levels. This graph shows the monthly forward P/E ratio for the S&P 500 going back to 1999. At the end of the third quarter, the S&P 500's forward P/E of 21.8 times exceeded the historical average of 16.5 and was more than one standard deviation above that historical average.

Similarly, the graph on slide 17 indicates that the S&P 500 might be overvalued. This graph compares the current forward P/E to the 20-year historical average for the 11 industry sectors in the S&P 500. The current forward P/E exceeds the historical average in 10 of those 11 sectors, suggesting that the market's overvaluation is broad-based and not confined to a limited number of sectors.

Despite the previously mentioned strength in hourly earnings and employment, and the recent decline in inflation, consumers do not appear to be very optimistic about the U.S. economy. This graph shows the University of Michigan's Consumer Sentiment Index going back to 1978. The index measures consumer attitudes and expectations about the economy. While the index improved recently, it remains below the historical average, suggesting that consumer spending might be sluggish going forward.

The next slide indicates that delinquency rates on credit cards and consumer loans, while relatively low on a historical basis, increased since bottoming back in 2021. This suggests that financial distress among consumers is headed in the wrong direction.

Finally, the next slide shows GDP growth over the past five years and forecasts from 2024 through 2027. As you can see, real GDP growth is expected to decline in 2024 and to remain below the 50-year historical average of 2.7% in each of the next four years.

To conclude, we believe it is very difficult to predict the short-term direction of the economy and equity markets. Numerous factors could strengthen the economy and continue to drive the equity market higher, while others could weaken the economy and cause the market to drift sideways or trade down. Despite these uncertainties, we will continue our strategy of investing for the long term and purchasing the undervalued stocks of high-quality companies with strong competitive advantages and high returns on capital. We believe this strategy should result in attractive risk-adjusted returns throughout various economic and market cycles.

JENSEN INVESTMENT MANAGEMENT

5500 Meadows Road, Suite 200
Lake Oswego, OR 97035
800.221.4384

jenseninvestment.com