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TRANSCRIPT
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Money Life with Chuck Jaffe

High-Quality Businesses at Reasonable Prices

Featuring Jensen Portfolio Manager Allen Bond

***CHUCK JAFFE:** Welcome to the Market Call, the part of the show where we talk with experienced money managers about how they do their job, what they look for that determines their buys and sells, what they see happening broadly on the market, and how they put it all together.*

JAFFE: Joining me today is Allen Bond. He is Portfolio Manager and Head of Research at Jensen Investment Management. If you are looking for more information on Jensen and the Jensen Funds, you're going to go to jenseninvestment.com. And again, it's high-quality businesses at reasonable prices. We'll talk about what that means.

Allen Bond, great to have you back on Money Life.

ALLEN BOND: Thanks for having me back.

JAFFE: So we always start with methodology, but I'm old enough to remember when quality was not considered a factor, it was just kind of like, "Yeah, that's a quality company." But now it's a factor, so we have to define quality, and we've always had to define reasonable prices. So, tell us what goes into the methodology, how you pick the businesses and decide on the prices.

BOND: Yeah, I think to your point, quality's definitely gotten a lot more attention here recently as a factor. Our version, or the way we look at quality, really hasn't changed much over the last 30 years. We're looking to invest for the long term in businesses that we think will grow and create business value, and we want to participate in that business value creation as shareholders.

And so we're focused on quality attributes that we think will lead to that sustainable business value creation. So, it's companies with sustainable competitive advantages, it's companies with attractive growth prospects, and companies with financial strength that will allow them to get through the tough

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www.jenseninvestment.com/insights/money-life-high-quality-businesses times but also have enough cash to invest in these high-return projects that are going to allow them to grow and create value.

On average, we'll hold stocks seven to eight years. We've held some much longer than that. So it's really kind of a more of an old-fashioned way of investing in that regard. The reasonable price part is this for us, we want to buy with a margin of safety. We think there's two key risks to long-term investment. The first is business risk, and we think we can mitigate that business risk by focusing on high-quality businesses, proven business models, competitive advantages, so on and so forth.

Pricing risk is the other long-term risk to investors, and we think we can mitigate that by making sure we have a margin of safety. So we're paying a price below what we think a business is ultimately worth. And when we put those two factors together, we think we can create a portfolio of high-quality businesses trading at a reasonable price that are likely to track alongside business value creation over the long term.

JAFFE: In terms of this market where we have seen so much action in so few stocks, has that made it easier for you to find quality businesses at reasonable prices?

BOND: I think the answer to that is yes and no. The market so far this year feels very similar to how we ended 2023. There's been a really acute focus on artificial intelligence and the development of artificial intelligence, but also the longer-term implications of applications based on artificial intelligence.

And so what we saw last year was all the talk about the Magnificent Seven. The reality is the majority of the top-performing stocks last year were technology or technology-related stocks. So "Magnificent Seven Plus" is kind of the way we would look at it, and it was the market trying to grapple with these longer-term implications of artificial intelligence.

As quality managers, we think we have very good exposure to this artificial intelligence trend within our portfolio and within our opportunity set, but there are some stocks that have been really right in the epicenter of the artificial intelligence movement that don't qualify for our universe because they haven't demonstrated that long-term track record that we look for. So, we try to find pockets within where we can see high-quality businesses that we think can benefit from this development in the near term and in the future.

JAFFE: What's a poster child for the methodology? What's an exemplar or two for what you're finding right now?

BOND: For us, it starts with high and consistent return on equity, and we think that's a really good barometer that if a company's got a high level of return on equity and can do that year in and year out, this is a hallmark of a high-quality business. And so we want to see companies that have proven they can do it, business models that are proven and then ones we think have staying power into the future.

A really good example of some of the trends I talked about with artificial intelligence, maybe the most well-known company is Accenture. Accenture is an IT consulting firm and they've got deep and entrenched relationships with most of the large businesses around the world.

Traditionally, those are doing traditional IT projects, but they've made a large investment last year in enhancing their capabilities around helping companies use artificial intelligence to make business processes more efficient. And because of their entrenched relationships with these companies, we think they're very well-positioned to benefit as companies want to use these applications and need Accenture's help to help them do that.

In fact, we heard today recently during earning season about companies and their IT managers getting more and more resources because the companies don't want to be behind their competitors in terms of using AI to make their business more efficient.

JAFFE: Accenture, ACN, what's something else that stands out to you right now?

BOND: Yeah, I think another one where we think again fits this trend is KLA Corporation. KLA is a semiconductor equipment company. They dominate the space for up-front quality control.

And so what their products do is they help semiconductor manufacturers find defects in silicon wafers before they start the semiconductor manufacturing process. And this is critical because if you have a defective silicon wafer, you're going to end up with defective computer chips and they're worthless.

So KLA's role plays a really important role upfront in the process. It's a space they dominate with dominant market share, very good and recurring service revenue business, and it's a high-margin business. So they stand to benefit as more computing infrastructure or semiconductor infrastructure is built out.

And you may have seen in the news, Sam Altman said that we're going to need something like $7 trillion of investment in computing infrastructure to meet the demands of AI. Well, as this infrastructure is built, KLA is a company that we think is naturally going to benefit as new capacity comes online over time.

The other trend that benefits them, it's related but it's not exactly the same, is we're seeing this nearshoring of semiconductor manufacturing where it's looked at more these days as a strategic industry for governments. And so they want to have more expertise in-house relative to outsourcing it all over the world like it's been historically.

So again, this to us means more semiconductor manufacturing facilities being built, which means more content for KLA's products.

JAFFE: What makes you sell? What makes you say it's time for us to move on from something?

BOND: There's three factors that we focus on from a sell discipline standpoint. The first is really simplistic or really straightforward. I mentioned high and consistent return on equity. Well, the barometer for us is 15% ROE for at least 10 years in a row.

And that creates our investible universe. And the reality is that universe is relatively really stable. Once a company's demonstrated that track record, more likely than not they're going to continue it. But if ROE falls below 15% for a reason that we think is sustainable, so it's not due to a one-time item, it would fall out of our universe and we would sell it from the portfolio.

It doesn't happen all the time. Typically, what'll happen is a function of capital allocation where companies decide they want to issue equity to fund projects and so forth that could change their capital allocation and result in ROE declining. But that's number one.

Number two is valuation. I mentioned the margin of safety. And we want to purchase with the margin of safety and we want to stay invested with the margin of safety. If a share price exceeds our estimate of full value, we will work our way out of the stock. And the reason for that is we want to take pricing risk out of the portfolio as much as possible.

Third reason is just business fundamentals. We have an idea within the portfolio we think we'd rather own more of, or maybe we have something within our opportunity set that we want to put the portfolio, or if fundamentals have deteriorated for a portfolio holding and we think we just need to get it out, we would make a change for that regard. So ROE decline, valuation triggers, and more of a qualitative view on business fundamentals is what drives our sales.

> "[Finding a high-quality business] starts with high and consistent return on equity, and we think that's a really good barometer that if a company's got a high level of return on equity and can do that year in and year out, this is a hallmark of a high-quality business. And so we want to see companies that have proven they can do it, business models that are proven and then ones we think have staying power into the future."

JAFFE: How much in these market conditions is it also that ability that okay, you've got those things that are not working, but what if you find something else? You're fully invested and there's a, I won't call it a faster horse necessarily, because you're looking at quality and pricing and what have you, but a better horse?

BOND: Yeah, and I think that goes back to that third piece that I talked about from the sell discipline standpoint. And what we really want to have is a robust bench of portfolio candidates that's going to put pressure on the portfolio so that our best ideas are in the portfolio all the time.

From a process standpoint for us, we meet daily as a team to discuss these ideas and others, stay abreast of news and earnings and so on and so forth. And through that process, if something does bubble up and we think there's a better opportunity on the bench, we can go ahead and make that change.

Now, the reality is for us, we're trying to make these decisions based on long-term signals as opposed to short-term noise, so we don't turn the portfolio over a lot. On average... Well, I'll just say this, last year we had four wholesale changes. We sold three stocks and bought one.

JAFFE: That's why I was asking, because when you were describing the process, you're talking eight or nine years, but as I listened to it I could go, "Well, wait, I could see something as we're talking about what we sell. On the one hand we could be selling because of all the reasons. On the other hand, there's this company out there that's waiting to come in."

That's why I asked the question. That's a great answer to it, because I think that's part of it, is for us to understand that it's going to take a lot, you'll add it to the bench and have it waiting to get into the game, but it's going to take a lot for you to put it into the game is what I took from there.

BOND: From a process perspective for us, we have a bench of portfolio candidates that we follow just as closely and monitor just as closely as we would a portfolio company. And so the idea is that when there's an opportunity that's ready, we're ready to act and we don't have to do a lot of additional work to get a stock in the portfolio. It allows us to be opportunistic but hopefully patient at the same time.

JAFFE: Now we're going to get your quick and dirty take on some stocks my audience is particularly interested in. We are having fun talking with Allen Bond, Portfolio Manager and Head of Research at Jensen Investment Management. We find him helping as one of the managers on the Jensen Quality Growth Fund, JENSX, Jensen Global Quality Growth, JGQSX. Learn more about those funds, also Jensen Quality Value, at jenseninvestment.com.

Quick and Dirty is our lightning round. It's where we put our guest to your test. If you want to get involved, send your name, your hometown and the ticker symbols you're interested in to chuck@moneylifeshow.com. We'll add them to our list and hope they make it into an interview soon.

We start today with a request from Tom in Smithfield, Kentucky, another Tom in Sun Prairie, Wisconsin, and Rick in York, Pennsylvania, all of whom want to know about Starbucks, SBUX.

BOND: So Starbucks is a holding for us, obviously a well-known business with a strong brand and a really strong global franchising model.

We own it for the brand. We think there's a lot of growth that still can happen as they expand that brand globally and into different distribution channels.

What we're seeing right now with Starbucks is a little bit of a lull. That China slowdown has hit Starbucks because that had been a primary growth driver for them. We look at this as more of a short-term hurdle as opposed to a long-term issue. So we continue to hold the stock and think it's a good quality stock for long-term investors.

JAFFE: Yep. Wake up to Starbucks, SBUX. That was a buy.

Now, the interesting thing, that request shared by those three guys, each one gets a request on their own. Tom in Sun Prairie, Wisconsin wants to know about Apple, AAPL.

BOND: Yeah. Apple's a company that really doesn't need much of an introduction. And similar to Starbucks, actually the Chinese end market has been a bit weak for them as the Chinese economy has struggled to come out of the pandemic period. And we're a little bit of a lull right now from a product launch standpoint. So the top-line growth has been relatively flat here in the last few quarters.

We think that we're expecting to see the iPhone 16 here come in the fall. We think that could revitalize the top lines, but what's important for us is that their services business continues to grow. And even though a lot of their products didn't grow much in the last quarter, the service businesses did grow.

This is important because it's sticky, it's high-margin, and it's recurring revenue. And we think that as that service business continues to grow and become a bigger part of the overall pie for Apple, business becomes more high quality, and so Apple continues to remain a top holding for us.

JAFFE: Yeah, money on the service side, maybe the sales side, that is a case for buying Apple, AAPL.

The other Tom, the one from Smithfield, Kentucky, he wanted to know about United Parcel Service, UPS.

BOND: Yeah, so United Parcel Service is a stock we actually sold from the Quality Growth Strategy last year, and I think it's a very good business with a strong brand and a very powerful global logistics network. Those remain intact.

What has changed with UPS is that they appear to have lost share here in the last-mile delivery as Amazon has built out their own delivery network, so there's not as much of a benefit to them from the e-commerce boom that we may have seen a few years ago.

The other issue is that they just renegotiated their labor contracts, and so we expect that there could be margin pressure as a result of that going forward. So we expect lower growth and maybe a bit more margin pressure, and that led us to get out of the stock last year.

JAFFE: Well, you heard the malfunctions that are there that make it so that UPS, good company, bad stock, that was a sell or an avoid. Next for Rick in York, Pennsylvania, ASML Holding, ASML.

BOND: ASML is a really neat company and an example of an extremely high-quality business. It's a Dutch-based semiconductor equipment manufacturer. They're probably among the most advantaged of those companies in the world. They make lithography machines, which are used to imprint circuits on computer chips.

And their machines, which cost hundreds of millions of dollars, are the size of double-decker buses, among the most highly engineered instruments in the world, are the only ones that have the technology to produce the smallest chips which are needed for all the cutting edge technology that we talk about.

So this is a company that's, again, we think really well-positioned to benefit as we see growth in artificial intelligence and other computing needs. They dominate that space throughout the world, and it is a company that is guided out to almost near the end of the decade in terms of financial goals. And we think they've got the business model that allows them to do that.

So, again, high-quality business. It's one we own in our Global Fund, and we think a very good stock for long-term investors.

JAFFE: That's a buy on ASML, ASML Holding.

And last, in the limited time we have left for Ryan in Anchorage, Alaska, GlaxoSmithKline, GSK.

BOND: Glaxo is a U.K.-based pharmaceutical business. They have a couple of good franchises, the world's leading shingles vaccine. They've got a good respiratory portfolio and they've got one of the leading HIV treatment portfolios.

So it's a good business. It's a stable business. It's been through a lot. There have been a lot of changes with divestitures and spin-offs and so forth. But what's left right now is really that core pharmaceutical business. It's fine. Probably going to be low growth.

The areas I mentioned are not the fastest-growing areas in pharma. We think there are probably better opportunities within pharma to get exposure to some more growth and more exciting opportunities. And so it's one we held several years ago in our Global Strategy, but we sold it and have moved on to better ideas.

JAFFE: Yep. You're taking your profits on GSK, GlaxoSmithKline. That was a sell.

And we have profited from our conversation with Allen Bond. Allen, this was great. Thanks so much. We'll talk to you again down the line.

BOND: Yep. Thank you.

JAFFE: Allen Bond is Portfolio Manager and Head of Research at Jensen Investment Management. [Visit] jenseninvestment.com to learn about Jensen Quality Growth, JENSX, Jensen Global Quality Growth, JGQSX, and more.

And speaking of more, well, we'll come back. We'll tell you where Allen agreed or disagreed with recent guests and we'll tell you what's coming for next week before we put a bow on this week. Stick with us.

And we have profited from our conversation with Allen Bond. Allen, this was great. Thanks so much. We'll talk to you again down the line.

Margin of Safety: Buying with a "margin of safety," a phrase popularized by Benjamin Graham and Warren Buffett, is when a security is purchased for less than its estimated value. This helps protect against permanent capital loss in the case of an unexpected event or analytical mistake. A purchase made with a margin of safety does not guarantee the security will not decline in price.

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