Quality Growth Fund Quarterly Update: 4Q 2025

Hosted by Allen Bond, CFA, *Managing Director, Head of Research & Portfolio Manager*, and Jeff Wilson, CFA, *Portfolio Manager*

ALLEN BOND: My name is Allen Bond. I'm the co-portfolio manager for the Jensen Quality Growth Strategy. I am joined today on the webinar by my colleague, Jeff Wilson. For the call, I will begin with a brief overview of our firm and investment philosophy. Jeff will cover quarterly performance trends and portfolio changes, and I will then conclude our prepared remarks with some comments on market trends and our outlook. Finally, we will conduct a Q&A session at the end of the call. You can submit questions any time into the webinar portal.

We'll start with a brief overview of Jensen Investment Management. Jensen is an employee-owned investment management company focused on quality investing strategies. The company was founded in 1988 by Val Jensen. Today, we manage approximately $6 billion across three investment strategies.

The first is Jensen Quality Growth. It is a large cap equity strategy focused on the long-term ownership of high-quality value-creating businesses. It was launched with the founding of our firm in 1988 and has been available in mutual fund forms since 1992. It is our flagship strategy, accounts for the vast majority of our assets under management (AUM), and will be the focus of the call today.

Next is Jensen Quality Mid Cap. It's an equity strategy focused on investing in mid-sized high-quality businesses with a bit more focus on stock price valuation. The strategy's composite was launched in 2008, the mutual fund was launched in 2010, and the strategy was essentially rebooted in 2017 by focusing on fundamental business research similar to that of the Quality Growth Strategy. So today, the Mid Cap Strategy is very similar to Quality Growth, but with a focus on mid-size businesses.

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And then last is Jensen Quality Global. It is very much an extension of the Quality Growth Strategy with an expanded investible universe that includes companies domiciled overseas. It was launched in April 2020, and will achieve its six-year investment performance track record in a few months.

This slide shows an overview of our investment philosophy, and there's obviously a lot here. I think the simple way to sum it up is that we seek to invest for the long term in businesses that can grow and create value. As a result, we focus our research on factors that are linked with sustainable business value creation. These include high business returns, competitive advantages, free cash flow, and business model consistency. We also identify growth drivers, not always explosive growth, but steady, consistent, and predictable growth.

We also pay close attention to stock price valuation. We maintain discounted cash flow models on all the stocks held in the portfolio and only investment shares trade below our estimate of intrinsic value. To us, the importance of valuation is twofold. First, it provides a margin of safety to manage against long-term pricing risk. And second, it maximizes the chance of traction between business results and share price appreciation over the long term. The result, in our view, is a portfolio of high quality, fairly valued stocks. With that, I will turn the call over to Jeff to discuss quarterly investment performance and portfolio changes.

JEFF WILSON: Thanks, Allen. Here we have a review of the investment performance for the Jensen Quality Growth Fund. As you can see, the Fund underperformed the S&P 500 Index by 320 basis points in the fourth quarter with I Shares down 54 basis points versus a return of 266 basis points for the S&P.

At a high level, the Fund's underperformance was impacted by a continuation of the largely risk-on high beta rally witnessed since the April 2025 lows. Specifically, several high quality factors remained out of favor during the period as witnessed in the two previous quarters, acting as a notable headwind for our investment discipline with Q4 returns driven by lower-quality factors, such as volatility and short-term momentum, as shown on the Style Factor attribution table, with some welcome broadening to style trends to include growth, valuation, and shareholder yield components. However, the results do support our experience where low quality outperformed high quality over the period and since April 2025 lows.

As we touched on last quarter, markets have enjoyed a sort of Goldilocks environment since the April 2025 lows. With the initial tariff-related fears gradually de-escalating and resulting in the labor market, economic growth, and inflation expectations, threading the needle as being not too hot or too cold, and providing a supportive backdrop for interest rate easing and financial deregulation that has supported risk-taking in the markets over the past nine months. While the bull market over the past three years favoring high growth and high volatility stocks isn't an environment where we would expect to outperform, the magnitude of underperformance has been notable. However, we consistently and closely monitor the underlying health of our portfolio companies and are encouraged by the underlying earnings growth that once again outpaced value of the market on a weighted average basis over the past 12 months.

Given the low quality characteristics of this rally, it isn't overly surprising that strong underlying business performance within our high quality portfolio of companies has yet to be rewarded. However, we do expect long-term fundamentals to ultimately prevail as stock prices and shareholder returns tend to closely follow earnings and free cash flow growth over the long term.

As we alluded to last quarter, there are several market dynamics we are paying close attention to, including employment trends, consumer spending, AI capital investment, private credit, and signs of exuberance worth monitoring. In many ways, this is not a normal market environment, which presents both risks and opportunities for investors. It's our belief that in times like these, it remains imperative for investors to remain disciplined, and to closely monitor the underlying health of the business fundamentals and sustainability of competitive advantages.

In terms of attribution, stock selection within Industrials, IT and Financials weighed on relative performance, partially offset by stock selection within Communication Services. We'll now examine our largest individual contributors and detractors during the period in greater detail.

The Fund's top individual performance contributor in the fourth quarter was Eli Lilly. We first initiated a position in Eli Lilly in June 2025, partially funded via UnitedHealth sales proceeds, as Eli Lilly offered a superior long-term investment opportunity in our determination. Eli Lilly is a leading global pharmaceutical company with a broad portfolio spanning diabetes, obesity, oncology, and immunology. Our investment thesis reflects Lilly's market-leading position in diabetes and weight loss therapeutics, addressing significant unmet need, a deep pipeline aimed at sustaining this leadership position, and a strong execution track record resulting in a durable growth profile and sustainable competitive advantages. The company's shares rose over 40% during the fourth quarter, driven by strong financial results from its current portfolio and encouraging pipeline developments, including next-gen and oral GLP-1s set to expand the market. Eli Lilly is a core holding in the Fund, finishing the year as a top 10 position on both an absolute and relative basis.

The leading individual detractor to Fund performance during the quarter was Microsoft. Microsoft underperformed in Q4 with the stock trading down right around 6.5% during the quarter. Now, this is an opportunity to highlight the market's focus on short-term results in this case, which can deviate from opportunities over the longer-term time horizon. Specifically, Microsoft CFO Amy Hood noted demand again exceeding supply across workloads, even as more capacity was brought online. Now, we've seen robust hyperscaler spending across the board, and while this clearly increases the capital investment and intensity for these businesses, we view the spending as, one, bolstering competitive advantages in this case for Microsoft as barriers to scale continue to ratchet higher, and two, an underappreciated optionality that goes along with the data center spend for Microsoft and several other players. In a nutshell, Microsoft is a quality compounder that benefits from very strong competitive advantages across its various end markets and remains a core holding within the Fund.

Next, we will offer some perspective on portfolio changes during the period. We made six significant portfolio changes, four of which we'll cover in detail in the coming slides. First, we sold three positions during the period: Accenture, Amphenol, and Zoetis.

Amphenol is a business we've owned for most of the past 17 years and was sold purely based on our valuation discipline. The business itself is performing wonderfully, and we continue to monitor it closely for an opportunity to add the position back to the portfolio at an adequate margin of safety.

Zoetis and Accenture fall into a different category, experiencing slight but clear deterioration in both growth and competitive advantage profiles. Zoetis is a leader in the animal health market. However, sales growth from its established drugs waned, and its once promising drug pipeline underwhelmed. We opportunistically trimmed the position in August using proceeds to bolster our position to Eli Lilly, which offered a clear upgrade within our healthcare exposure in our determination. We sold the remaining small Zoetis position in Q4 to fund new additions to the portfolio, which we'll detail here shortly.

Accenture is a global management consulting technology services and outsourcing company. The company remains a bellwether for large IT database and cloud migrations. However, our analysis points to AI or artificial intelligence presenting a material long-term risk to their core consulting business model, particularly surrounding a likely shift from billable hours to more outcomes-based services. While it remains a quality company, we've reduced the position materially over the past year in favor of companies with strengthening competitive advantages and accelerating growth prospects. In the coming slides, I'll detail three such examples.

We added three new companies to the Strategy during the period, Amazon being the first. Amazon operates three highly attractive leading global businesses, including the largest global e-commerce platform in Amazon.com, the largest cloud computing platform in Amazon Web Services or AWS, and the number three global digital advertising platform behind only Google and Meta, companies also owned by the Fund.

Amazon's e-commerce business is a two-sided marketplace with classic network effects that are reinforced by Prime loyalty, its unrivaled logistical scale, and proprietary first-party data that helps power its high margin digital ads platform. We see Amazon's e-commerce business as uniquely positioned to compete in the AI age with LLMs and

AI agents prioritizing e-commerce queries based on three main factors: price, trustworthiness, and speed, all playing directly into Amazon's unique capabilities and strengths. AWS benefits from a strong developer community and deep integration into enterprise workloads.

In addition to the long-term secular growth we see in continued cloud migration, we see solid optionality from Amazon's AI investments within a capacity constrained environment. Simplistically, we see the competitive advantage profile strengthening across Amazon's core businesses. Amazon's leadership embodies the "only the paranoid survive" philosophy first evoked by Andy Grove through its relentless focus on customer centricity and proactive defense of its leading market positions through consistent reinvestment in the business, enabled by a strong balance sheet and robust free cash flow generation.

Next, we also added Broadcom during the period. Broadcom is a leading semiconductor and infrastructure software company with strong positions in data center networking and custom silicon or ASICS, making it a core AI infrastructure supplier with chips and connectivity as the metaphorical picks and shovels for the AI infrastructure buildup. Broadcom enjoys predictable revenues and cash flows due in part to the multi-year engineering programs they are designed into, often spanning multiple product generations. This, combined with sticky customer relationships, offers a degree of predictability not always seen in these types of businesses.

Broadcom's scale, engineering depth, and manufacturing relationships make it a uniquely credible player in the ASICS market, as hyperscalers try to control their own destiny to the extent they can in AI infrastructure, in addition to practical benefits like customization around power and efficiency profiles. In summary, Broadcom is a diversified, high-quality business supported by a large base of recurring revenues and cash flows. Broadcom's proven management team has a strong track record of strategic execution and capital allocation acumen.

Our last portfolio addition to the Fund during the period was Motorola Solutions (MSI). Motorola Solutions is a differentiated business, specializing in mission-critical radio networks and devices used by first responders and government agencies. MSI has a dominant market position in land mobile radio, or LMR networks, benefiting from economies of scale alongside high switching costs, including strong financial, procedural, and relational switching costs. These infrastructure investments span decades, often including 10- to 15-year service contracts and serving as a stable, predictable cash cow for reinvestment and mergers and acquisitions (M&A) into faster growth areas and adjacencies, including command center software, video, and most recently via its Silvus acquisition entry into mission-critical unmanned defense communications via advanced mobile ad hoc networks.

Motorola Solutions' management team has a strong track record of execution and alignment with long-term shareholders to drive per-share value creation. Motorola Solutions represents a classic Jensen Quality Growth business with strong and sustainable competitive advantages, a stable growth profile, and a reasonably attractive valuation for the quality of the business and the likelihood for enduring value creation. Beyond the companies we've profiled so far during this call, we'd be happy to answer any questions during the Q&A section on the call. And with that, I will turn the call back to Allen to discuss our outlook.

ALLEN: Thanks, Jeff. So, moving on to our outlook, the slide here shows a summary of our thoughts. Market concentration remains at historically high levels. However, we observe some subtle changes to the market and macroeconomic backdrop. For example, earnings growth is expected to broaden, and monetary conditions are slowly easing. That being said, the artificial intelligence investment theme continues as the primary driver of animal spirits within the markets, but we are seeing a trend where investors are becoming more discerning about the potential returns on these investments.

We view this scrutiny amongst investors as a healthy development. Relatedly, more of the apparent AI beneficiaries have met our quality standards in recent periods, and our portfolio has evolved to reflect these opportunities on a selective basis. At the same time, we continue to see long-term quality investment opportunities outside of AI, and this is where we believe our strategy is differentiated. We believe the portfolio is poised to participate in the continued AI field growth while preserving the resilience that has defined it in previous market cycles. That balance is intentional as we do not attempt to time the market. Rather, we remain laser-focused on identifying unique businesses that are poised to grow and create business value for the long term.

Next is a chart of S&P Index concentration over the past 30-plus years, and the conclusion here feels like stating the obvious. The market remains historically concentrated at the top. This phenomenon has become so normal, however, that it is easy to forget that it is actually highly abnormal. As you can see on the chart, the largest stocks today account for a greater share of market capitalization than during the peak of the Dot-com Bubble. And what is not shown on the charts, based on some estimates, is that the share today is higher than during the Nifty Fifty period , and during the Depression era in the 1930s.

There's been many ramifications of this trend, but one of the interesting things that we've noticed recently is that the S&P 500 Index on an equally weighted basis has materially underperformed the more traditional cap-weighted index over the past three years. As you can see on the slide, the last time we saw equally weighted underperformance of this magnitude was during the late stages of the Dot-com Bubble in the 1990s.

So, there's a variety of reasons for this disparity, but one that gets less mentioned is the difference in operating margin profiles. And we believe that explains some of the difference between the equally-weighted index and the cap-weighted index. As you can see, this chart shows margins for the cap-weighted index, and they have steadily advanced from early 2023 and are expected to expand rapidly this year. This margin gain can largely be explained by the business models among the large index constituents. While they are not identical, many of these technology-driven business models benefit from tremendous scale and operating leverage, which means that revenue gains result in disproportionate profitability increases.

But in contrast, with the exception of pandemic-related disruption, operating margins for the equally-weighted index have been essentially flat for more than a decade. This suggests that the benefits from operating leverage are not being shared by the broader market, and this chart may be more indicative of the underlying economic challenges that we're aware of, including supply chain disruption, inflation, and labor costs that we see across the broader economy.

But there are indications of some subtle changes that are taking place. This chart shows the year-over-year earnings per share (EPS) growth expectations for the Magnificent 7 versus the remaining 493 S&P 500 Index stocks, starting in the first quarter of 2025 through the fourth quarter of 2026. And it highlights an expected visible convergence in growth rates over the course of 2026. As you can see, earnings growth is projected to broaden beyond the Magnificent 7, and by year-end, earnings growth for the remaining stocks is forecast to slightly exceed that of the Mag 7, signaling a meaningful shift away from the narrow leadership we've seen over the past few years. In our view, this trajectory supports a market that is healthier, an earnings expansion that is more durable, and reduces the reliance on a small group of mega cap tech stocks to drive index level growth.

Moving on to monetary policy, this chart shows the trend in the fed funds rate over the past five years. As you can see, monetary policy tightened in 2022 and early '23 in response to an increase in inflation. It largely plateaued in 2024 and slowly eased in late '24 and into 2025. For equity markets, we believe this pivot towards dovish Fed policy supports valuations and favors broader market participation, which is consistent with the earnings expectations shown on the previous slide.

This chart shows the trend in total assets on the U.S. Federal Reserve balance sheet. As you can see, assets declined from mid-2022 until late last year, driven by the Fed's quantitative tightening policy and indicating a contraction in money supply. However, the Fed announced the suspension of quantitative tightening in early December of 2025, and as a result, money supply is no longer shrinking. In our view, this removes an understated and often overlooked macro headwind that we believe weighed on risk assets during the tightening phase across the broader market. For equity markets, the end of quantitative tightening, similar to more dovish Fed policy, supports improving financial conditions and broader market participation.

And yet, some things do remain the same. This chart shows the dramatic impact of data center investment on total construction spending. As you can see, the growth in data center investment has dwarfed construction spending across the broader economy. As we know, this investment in artificial intelligence has been a key driver of the bull market that commenced in late 2022. And, in our view, this theme still has legs. For example, we've seen a number of positive capital expenditure announcements from prominent companies in the AI and cloud ecosystem in recent periods.

The result of these developments is optimism amongst investors, which is reflected in elevated valuation multiples shown in the chart. What we show here is the trend in the P/E multiple for the S&P 500 Index since 1990. And as you can see, today's earnings multiple is higher than all but two periods, the dot-com mania in the late 1990s, and the pandemic-related distortion in 2020.

And, as we might all be aware, elevated valuation multiples often result in lower future investment returns. This chart shows average forward returns based on the starting P/E multiple tranches. As you can see, starting multiples in excess of twenty times, which is the case today, tend to lead to muted future returns, particularly over the long term.

The key question for us is: how *do* or *don't* these factors impact portfolio positioning? We'll start by answering the "don't" portion of that question because we think it's critical – and it's a key distinction. We *don't* change our investment philosophy, process or values. We remain laser-focused on business quality. And to that end, every company held in the portfolio has generated a high and stable business return over the past ten years. At a minimum, that means they are all profitable and cash generative. Additionally, based on our analysis, they all benefit from sustainable competitive advantages and unique growth opportunities. This is the formula for long-term business value creation. Now, admittedly, adhering to this discipline has led to weak relative investment performance over the past few years. However, we know that our approach has worked for long periods in the past, and we are confident that it will reassert itself again in the future.

Now, turning our attention to the "do" portion of that question: how *do* market trends impact portfolio positioning? Well, we are realistic about secular trends impacting the economy, in particular, the investment cycle supported by the ongoing development of AI models. Today, most of this investment has been centered on developing these models, which requires a tremendous amount of computing capacity and power. These efforts remain ongoing, but we expect the focus of this trend to shift towards the usage of these AI models. For example, we are currently discussing the impact of quote-unquote, "agentic AI" across the businesses held in the portfolio.

On this slide, the names that are bolded represent, in our view, the clear AI investment beneficiaries, representing in total about 42% of the portfolio. These include some longer-held positions such as Microsoft and Alphabet, as well as newer positions such as Nvidia, Amazon, Meta, KLA Corporation, Cadence, and Broadcom. Importantly, and this is critical, in addition to being likely beneficiaries from the AI infrastructure build-out, we view each of these businesses individually as exceptional with powerful competitive advantages and compelling growth prospects. Without that quality foundation, they would not be in the portfolio.

This slide shows the same portfolio but sorted by active weight, which is the difference between portfolio weight and the benchmark weight. As you can see, this provides a different lens into portfolio positioning. And we believe this is an important way to look at it because it highlights differentiation and it highlights conviction. As you can see, our highest conviction positions on a relative basis are primarily longstanding holdings that benefit from stable and resilient business models. And this positioning is intentional. We believe the portfolio is poised to participate in secular growth trends while still preserving the strategy's hallmark resilience.

So, in conclusion, market concentration in mega cap tech stocks continues to be a defining feature of the current market environment. Our approach is not to avoid these businesses categorically, but to weigh their durability against valuation, capital intensity, and long-term competitive dynamics. Looking ahead, successful investing will require patience and discernment. We remain focused on owning businesses capable of compounding economic value over full cycles, emphasizing quality, cash generation, and resilience as the foundation for long-term shareholder returns.

We are tremendously grateful for the ongoing support of our firm and investment strategies from all of our clients and partners. For that, we thank you very much.

Definitions

Basis Point: Is a value equaling one one-hundredth of a percent (1/100 of 1%).

Capital Expenditures (CapEx): Cash outlays a company makes to acquire, build, upgrade, or extend the useful life of long-lived assets. CapEx is typically recorded as an investment on the company's balance sheet and can be calculated by adding current depreciation to the change in property, plant, and equipment (PP&E). Source: Investopedia.

Earnings Growth: The annual rate of growth of earnings typically measured as Earnings Per Share Growth.

Earnings Per Share (EPS) Growth: Illustrates the growth of earnings per share over time. **Earnings growth is not a measure of a fund's future performance.**

Free Cash Flow: Equal to the cash from operations of a company less capital expenditures.

Glucagon-Like Peptide-1 (GLP-1): An incretin hormone produced in response to food intake and is involved in glucose metabolism. Source: National Institute of Health

High Beta: Describes a stock or portfolio with returns that tend to be more volatile than the broader market, as indicated by a beta greater than 1.0.

Hyperscalers: a large cloud service provider that uses hyperscale data centers to offer massive, on-demand computing resources and services like storage, computing, and networking.

Magnificent Seven (MAG 7): A group of high-performing and influential companies in the U.S. stock market's technology sector recognized for their market dominance, technological impact, and changes to consumer behavior and economic trends. The stocks are Alphabet (GOOGL; GOOG), Amazon (AMZN), Apple (AAPL), Meta Platforms (META), Microsoft (MSFT), NVIDIA (NVDA), and Tesla (TSLA). Source: Investopedia.

Margin of Safety: a value investing tenet that provides a buffer against unpredictable loss by encouraging investors to purchase securities only when they trade below intrinsic value by a sufficient margin.

Nifty Fifty: A group of large-capitalization U.S. growth stocks that were favored by institutional investors in the late 1960s and early 1970s, and were widely viewed as "one-decision" buy-and-hold investments. Examples include General Electric, Coca-Cola, and IBM. Source: Investopedia.

Price-to-Earnings (P/E) Ratio: A common tool for comparing the prices of different common stocks and is calculated by dividing the earnings per share into the current market price of a stock.

Return on Equity (ROE): Is equal to a company's after-tax earnings (excluding non-recurring items) divided by its average stockholder equity for the year.

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