Implications of Index Concentration on Equity Market Return Patterns

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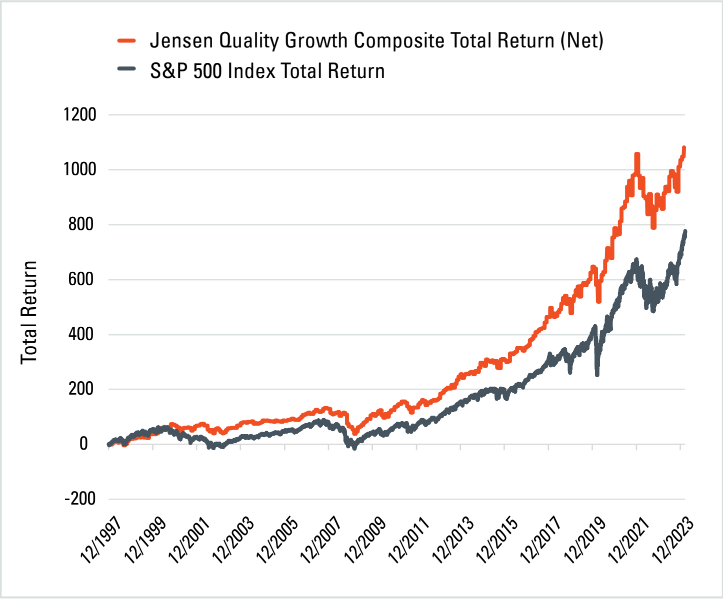
In more than three decades of quality investing, we have navigated economic cycles and witnessed the rise and fall of quite a few market darlings. Through it all, we have remained true to our investment discipline, investing in businesses that have produced long-term records of persistently high returns on shareholder equity. Largely, our patience and conviction have been rewarded. However, there have also been extended periods — like now — when even the most steadfast quality growth investor may waver. While past performance is not indicative of future results, we believe that previous patterns may help us, and our investors, better contextualize the current environment.*

We believe that stock market concentration has played a pivotal role in the bull market that commenced in early 2023. However, this period of lopsided S&P 500 Index ("Index") returns is not unprecedented in recent history. In fact, we have observed three previous instances of strong market returns that were associated with a top-heavy S&P 500 Index during the past 30 years. In each case, the bull market cycles linked with Index concentration were subsequently followed by market pullbacks.

Chart 2 on the following page shows the contribution of the 10 largest index weights to annual S&P 500 Index performance during positive return years since 1991. As you can see, prior to this most recent period of Index concentration (2023-present), there were three similar periods shown in the chart: 2007, 2020-2021 and 1998-1999.

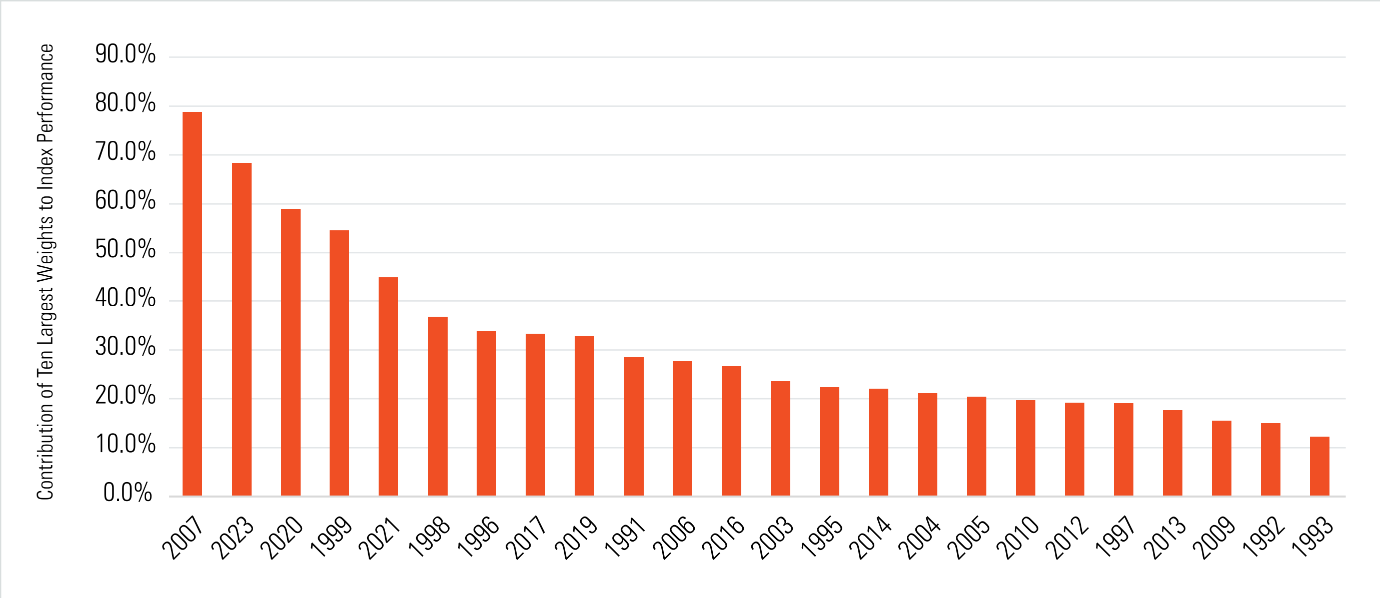
Chart 1 | **1998-Present: Long-Term Focus[1]**



* **Jensen Quality Growth Equity Composite (Net of Fees as of 12/31/2023): 1 Year 17.12%, 5 Year 14.48%, 10 Year 12.34%.**
S&P 500 Index: 1 Year 26.29%, 5 Year 15.69%, 10 Year 12.03%.

[1] Source: Y Charts as of March 22, 2024.

Chart 2 | **Annual S&P 500 Index Contribution of 10 Largest Weights In Positive Performance Years**[2]

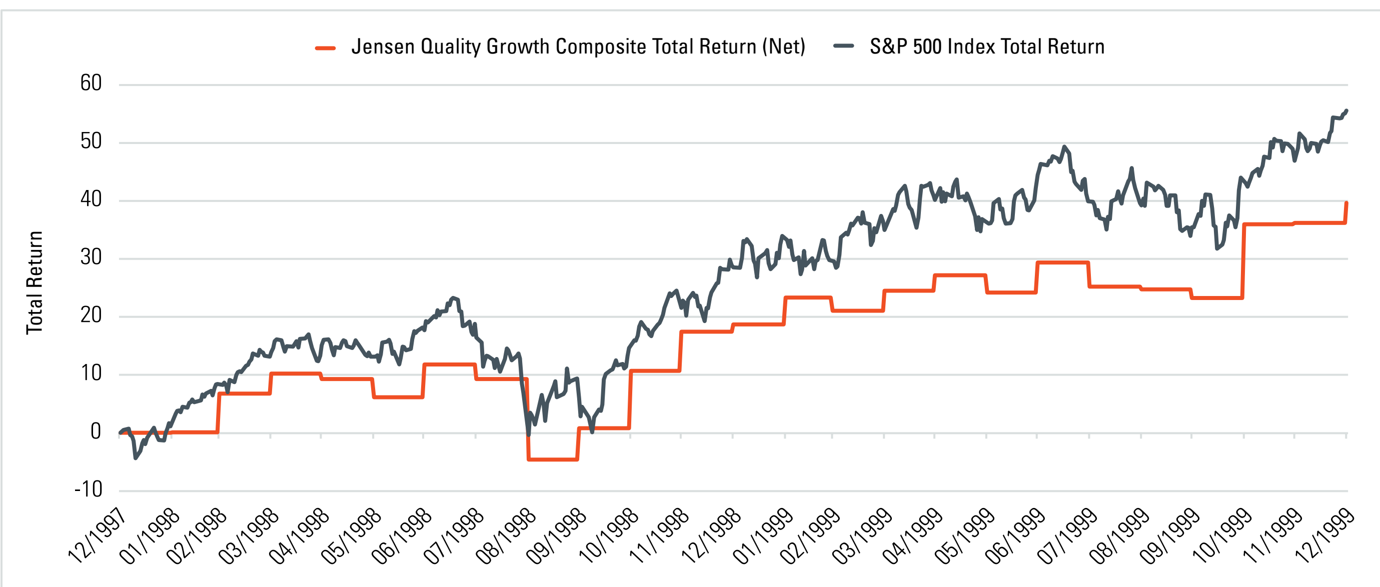


1998-1999: Dot-com Bubble

This era of strong market returns coincided with the global adoption of the internet, related investment technology investments and a multitude of dot-com startups. During this period, the S&P 500 Index produced a total return of 55.63%, led by shares in Qualcomm (QCOM: +2,690% in this period), Amazon (AMZN: +1,416%), Apple (AAPL: +683%), Oracle (ORCL: 653%) and Cisco Systems (CSCO: +477%). Additionally, stock price valuations soared with the trailing price-to-earnings multiple for the S&P 500 Index peaking at more than 30x trailing earnings in 1999, a near 44% increase from its level two years prior.[3]

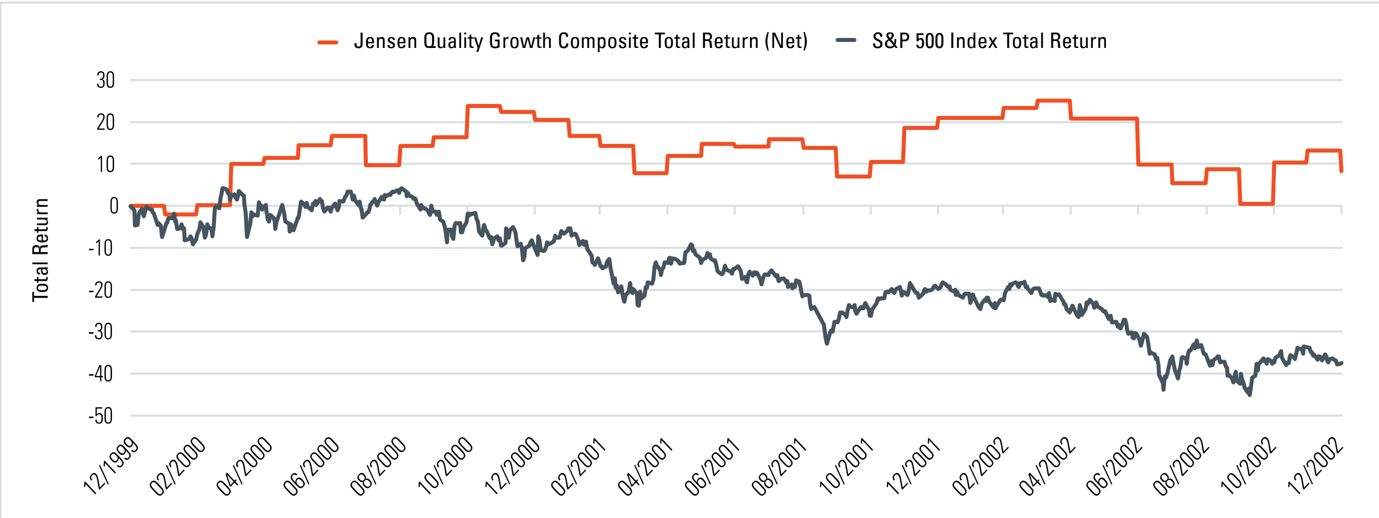
The Jensen Quality Growth Strategy underperformed the Index by 15.87%, which we attribute primarily to lower relative weightings in the large technology stocks listed in the previous paragraph.

Chart 3 | **1998-1999: Dot-com Bubble**[4]



[2] Source: Strategas Research, data as of December 31, 2023.
[3] Source: S&P Indices as of March 14, 2024.
[4] Source: Y Charts as of March 22, 2024.

Chart 4 2000-2002: Dot-com Bust[5]



2000-2002: Dot-com Bust

The three years from 2000-2002 were marked by a series of bankruptcies among unprofitable startup businesses and multiple accounting scandals. In this period, the S&P 500 Index produced a total return of -37.61%, weighed down by share price declines from some of the same companies that led the previous market rally. These included Qualcomm (-79%), Cisco Systems (-76%), Amazon (-75%) and Apple (-72%).

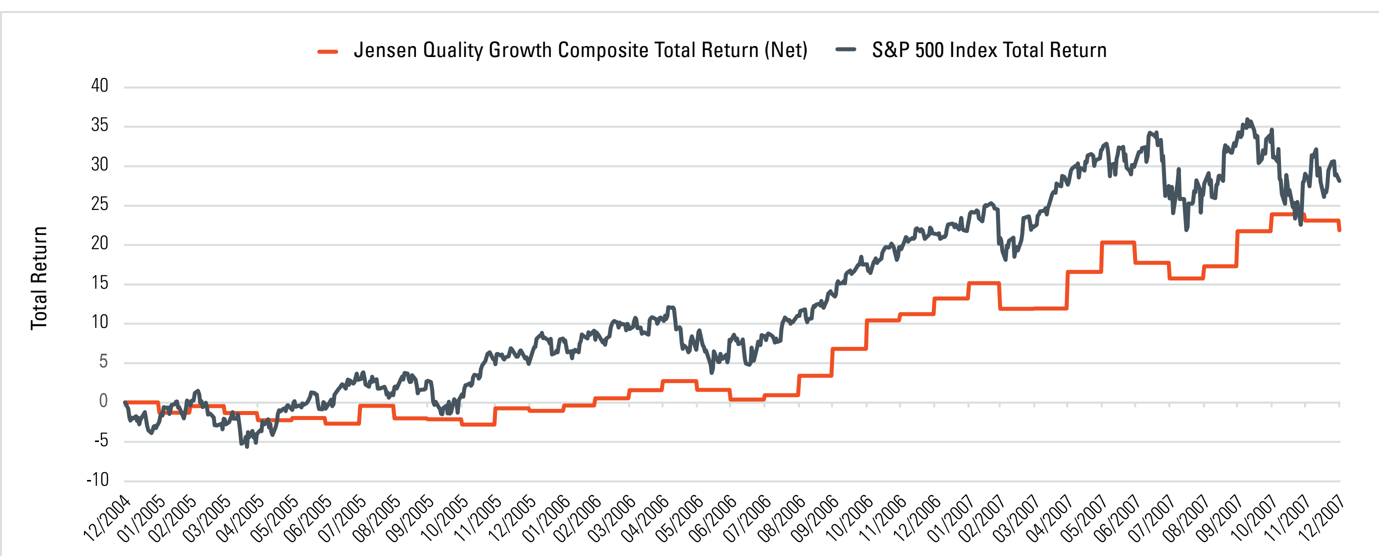
The Jensen Quality Growth Strategy outperformed the Index by 45.91%, primarily due to lower relative weightings in the same large technology stocks discussed above.

2005-2007: Lending Bubble and Peak Oil

The three years from 2005-2007 were characterized by a rapid increase in home prices,[6] reckless lending practices[7] and increased financial leverage through the use of collateralized debt obligations.[8] Over the course of this period, the S&P 500 Index appreciated 28.16%, led by Energy sector stocks such as Marathon Oil (MRO: +224% in the period), Valero Energy Group (VLO: +209%) and Occidental Petroleum (OXY: +164%).

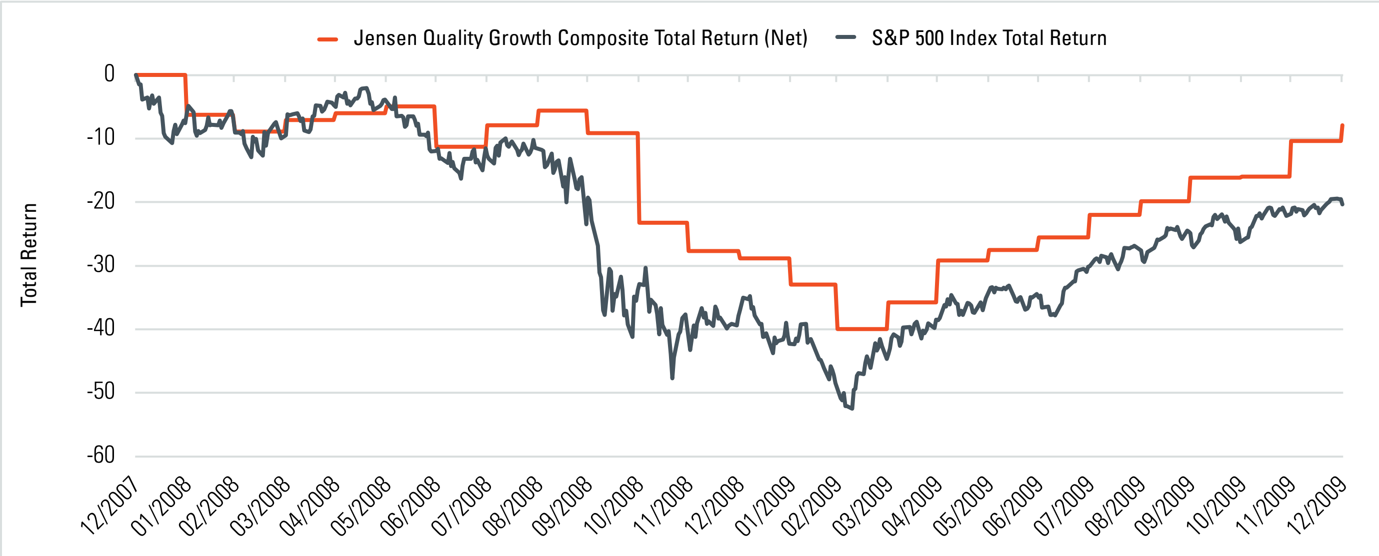
The Jensen Quality Growth Strategy underperformed the Index by 6.28%, which we attribute primarily to lower relative weightings in Energy sector stocks.

Chart 5 2005-2007: Lending Bubble and Peak Oil[9]



[5] Source: Y Charts as of March 22, 2024.
[6] Source: https://fred.stlouisfed.org
[7] Source: https://www.federalreservehistory.org/essays/subprime-mortgage-crisis
[8] Source: https://www.fdic.gov/bank/historical/crisis/chap1.pdf
[9] Source: Y Charts as of March 22, 2024.

Chart 6 | **2008-2009: The Great Recession[10]**



2008-2009: The Great Recession

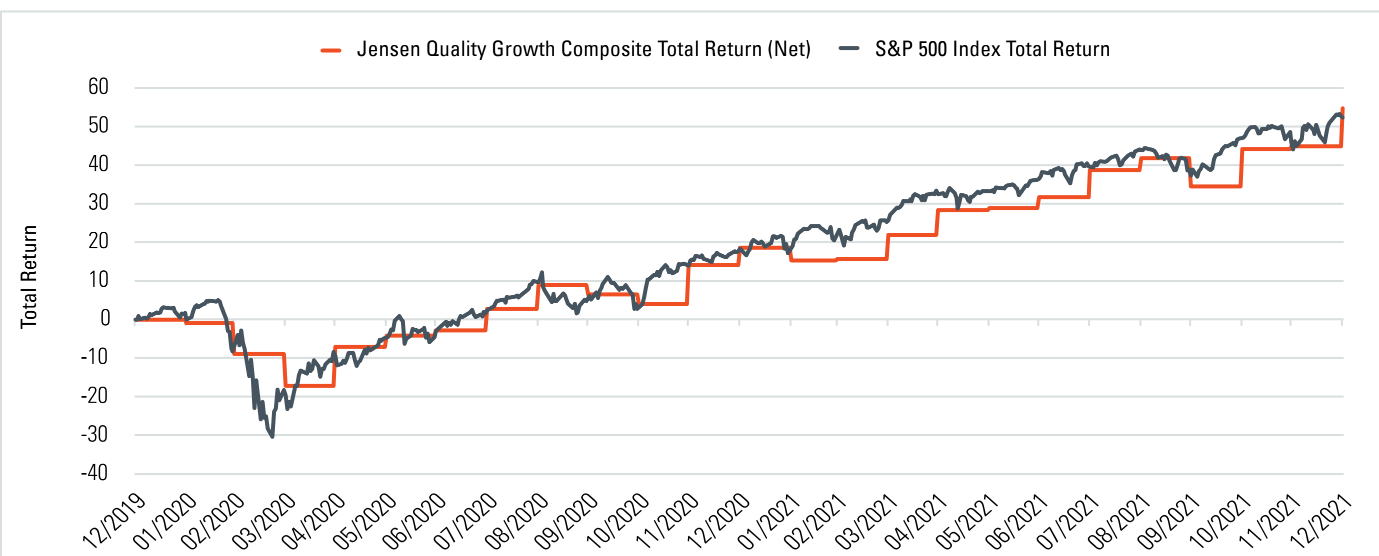
The period from 2008-2009, known as the Great Recession, was plagued by a number of bankruptcies among investment, retail and commercial banks. These failures were largely due to excess leverage, poor loan underwriting standards and excessive reliance on credit ratings that failed to adequately measure underlying systemic risks. In this period, the S&P 500 Index produced a total return of -20.32%, which was hallmarked by the near 100% equity drawdowns in businesses directly impacted by nonperforming loan losses such as Washington Mutual (WAMUQ: -99.8% in the period) and Lehman Brothers (LEHMQ: -99.5%). However, declines in General Electric (GE: -54.8%), Citigroup (C: -88.1%), American International Group (AIG: -97.4%) and Exxon Mobil (XOM: -24.1%) were the largest Index detractors.

The Jensen Quality Growth Strategy outperformed the Index by 12.46% which we attribute primarily to lower relative weightings in bank and finance stocks.

2020-2021: COVID-19 Pandemic and Policy Response

2020 and 2021 were characterized by a sharp sell-off during the initial stages of the COVID-19 pandemic followed by a swift recovery aided by an unprecedented combination of

Chart 7 | **2020-2021: COVID-19 Pandemic and Policy Response[11]**



[10] Source: Y Charts as of March 22, 2024.
[11] Ibid.

monetary and fiscal stimulus. In this period, the S&P 500 Index appreciated 52.39%, led by "magnificent seven" stocks Apple (+145.5% in this period), Microsoft (MSFT: +117.3%), Amazon (+80.45%), Nvidia (NVDA: +401.2%), Alphabet Inc. (GOOGL: +116.3%), Meta (META: +63.9%) and Tesla (TSLA: +52.1%).

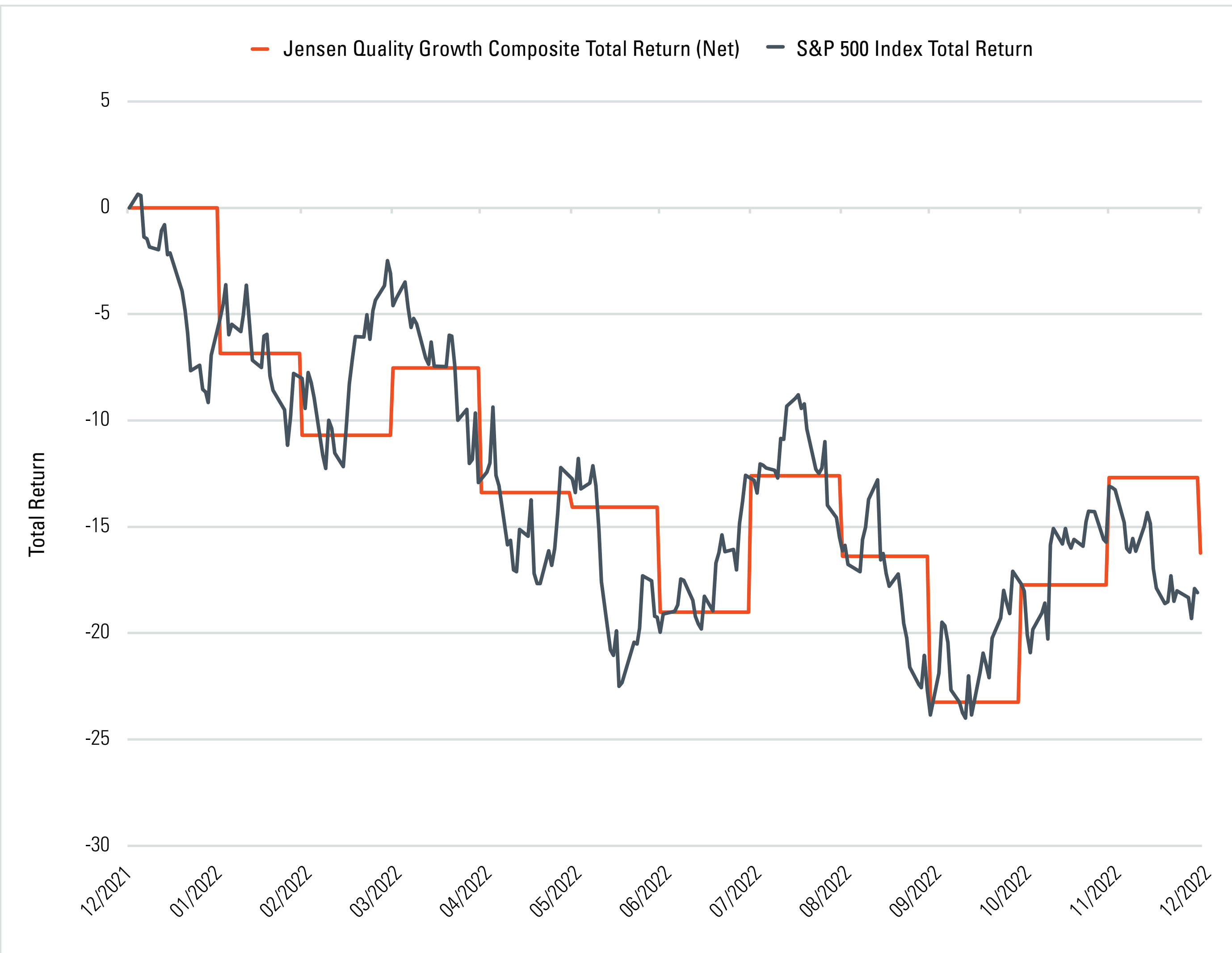
The Jensen Quality Growth Strategy outperformed the Index by 2.40%, which we attribute primarily to lower relative weightings in Financials and Energy sector stocks and security selection in Communications sector stocks.

2022: Inflation and Rate Hikes

Inflation began to rise sharply in 2021 and peaked in early 2022,[12] triggering hawkish monetary policy and higher interest rates. In this period, the S&P 500 Index produced a total return of -18.11%, weighed down by the same "magnificent seven" stocks — Apple (-26.4% in 2022), Amazon (-49.6%), Microsoft (-28.0%), Tesla (-65.0%), Meta (-64.2%), Nvidia (-50.3%) and Alphabet Inc. (-39.1%) — that had boosted returns during the prior two years.

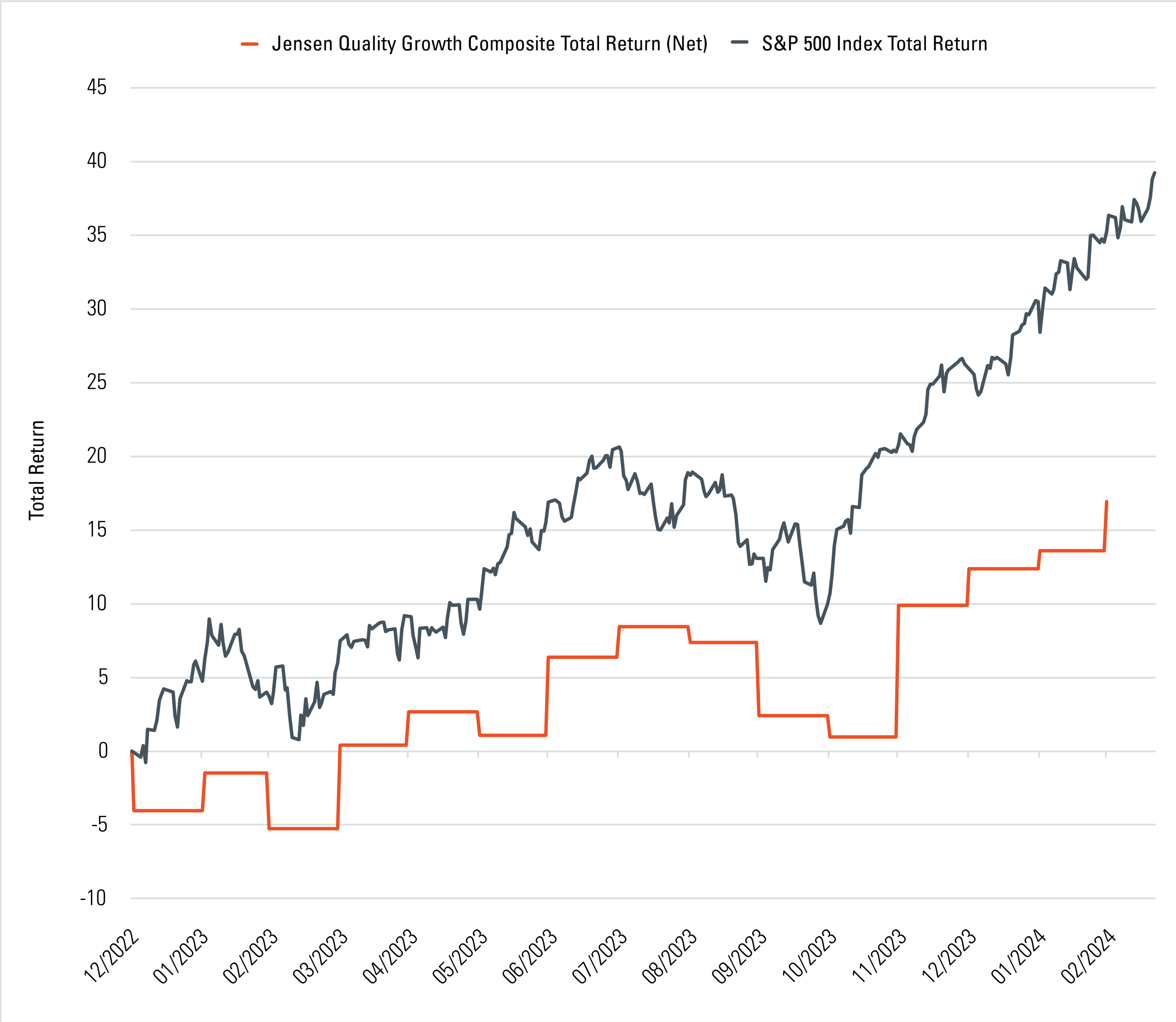
The Jensen Quality Growth Strategy outperformed the Index by 1.87%, which we attribute primarily to a higher relative weighting in Healthcare sector stocks and security selection in Consumer Discretionary and Information Technology sector stocks.

Chart 8 | **2022: Inflation and Rate Hikes[13]**



[12] Source: https://fred.stlouisfed.org
[13] Source: Y Charts as of March 22, 2024.

Chart 9 | **2023-Present: ChatGPT and Artificial Intelligence (AI)**[14]



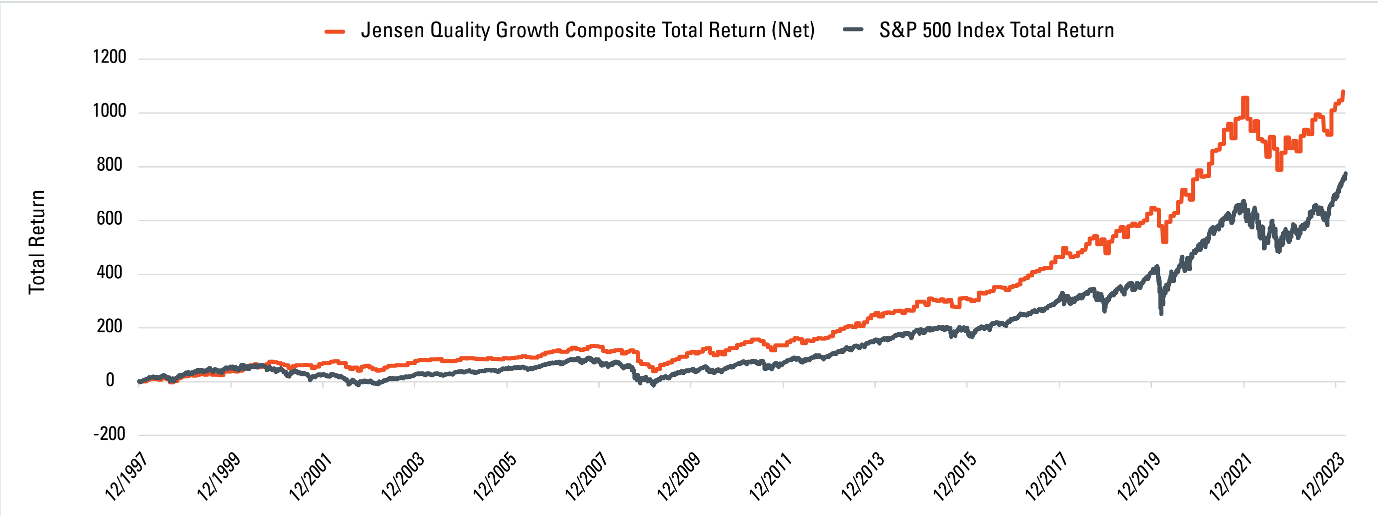
2023-Present: ChatGPT and Artificial Intelligence (AI)

ChatGPT was launched in November 2022 and reached more than 100 million active users in January 2023.[15] Further adoption of AI-driven large language models and investor enthusiasm that this trend would result in a wave of technology investment has fueled the current bull market. During this period, the S&P 500 Index produced a total return of +37.55%, led by Nvidia (+512% during this period), Microsoft (+77.6%), Amazon (+109.4%), Meta (+312.8%), Apple (+36.5%) and Alphabet Inc. (+66.7%).

Over the same time period, the Jensen Quality Growth Strategy returned 16.95% but underperformed the Index by 20.60%, marking an extreme example of weak relative returns during periods of increasing Index concentration. The underperformance arose primarily due to security selection in Information Technology and Consumer Discretionary sector stocks. In particular, the Strategy's lack of exposure to shares in Nvidia, Amazon, Meta and Eli Lilly (LLY) materially detracted from relative investment performance. Of these four stocks, only Meta and Eli Lilly qualify for our investible universe.

[14] Source: Y Charts as of March 22, 2024.
[15] Source: https://www.cnbc.com/2023/11/30/chatgpts-one-year-anniversary-how-the-viral-ai-chatbot-has-changed.html

Chart 10 | 1998-Present: Long-Term Focus[16]



1998-Present: Long-Term Focus

As managers of the Quality Growth Strategy, we are presently grappling with a period of acutely unfavorable short-term relative investment performance. In such times, it is useful to refocus attention on longer-term results. Chart 10 above shows absolute and relative investment performance over the entire course of the historical return periods analyzed in this piece. We believe this is the best case for maintaining our investment discipline, especially in times of relative performance uncertainty.

For a list of the Jensen Quality Growth Strategy's current holdings, please visit: https://www.jenseninvestment.com/growth-composite-holdings.

The company discussions in this article are solely intended to illustrate the application of our investment approach and are not intended as investment recommendations or an indication that our investment decisions have been or will be profitable.

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The S&P 500 Index is a market value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation. The index is unmanaged, and you cannot invest directly in an index.

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[16] Source: Y Charts as of March 22, 2024.