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TRANSCRIPT
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Quality Value Fund Quarterly Update: 4Q 2023

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 Value Fund. I want to welcome you to our webinar for the fourth quarter of 2023.

So here's our agenda for today's webinar. We will begin by reviewing the fund's performance during the quarter and some of the changes that we made to the portfolio during the fourth quarter. Then we'll discuss our outlook for the economy and the equity markets, and then we'll wrap up the webinar with Q&A.

Before jumping into performance, we'd like to provide a brief overview of Jensen and our philosophy for the quality value strategy. Jensen was founded in 1988, and the firm is owned by approximately half of our current employees. We manage approximately 13 and a half billion dollars in assets in three primary investment strategies. The Jensen Quality Growth product, the Jensen Quality Value product, and the Jensen Global Quality Growth product.

In terms of our philosophy for the Quality Value Fund, 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, it should generate high returns on capital. And if those returns on capital exceed the company's cost of capital, that's what drives the value of the business higher in the future. Our goal with the quality value product is to outperform the market when it is down and to capture a decent portion of the market's upside when it increases.

Moving on to performance, slide five shows the fund's performance over various time periods through 12/31/23. As you can see, the fund underperformed its primary benchmark, The Russell MidCap Index during the fourth quarter, but outperformed over the past one, three, and five-year periods.

The next slide compares the fund's fourth quarter performance to the Russell MidCap Index with a positive return of 11.99%, and as shown in the last row of the table, the fund underperformed the index return of 12.81%. From a sector standpoint, the fund's overweight in consumer discretionary, and underweight

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in energy and utilities, were the largest sector contributors to relative performance during the fourth quarter. Our overweight in consumer staples, and underweights in financials and real estate, were the largest sector detractors from relative performance. On the right-hand side of the slide, you see the top five individual stock contributors to and detractors from performance for the fourth quarter. We can discuss any of these 10 names during the Q&A at the end of the webinar, but we would like to review both Equifax and Genpact in detail on the next two slides.

Equifax is the fund's top individual contributor to performance during the fourth quarter. The company provides credit information on consumers and businesses to facilitate lending decisions. The company also provides employment and income data on consumers to lenders, potential employers, and governmental agencies to determine the eligibility for government assistance programs. A material portion of Equifax's revenues are tied to mortgage lending. The mortgage lending business has been very weak over the past several quarters as interest rates increased in response to tightening by the Federal Reserve to lower inflation. We believe Equifax's stock performed well during the fourth quarter of last year as inflation continued to moderate, interest rates declined, and investors increasingly expect the Fed to cut rates in 2024. Lower rates should improve the company's mortgage-related businesses going forward. Equifax is one of the largest positions in the fund due to its solid market position, unique data assets, attractive growth opportunities, significant barriers to entry, and the attractive price of its stock.

Genpact was the portfolio's top individual stock detractor from performance during the fourth quarter. The company provides business process outsourcing and IT services to its customers. We believe the stock underperformed due primarily to a slowdown in technology spending by the company's customers. This led to slower customer decision-making and a lengthening of the sales cycle. We believe these issues are short-term in nature, and Genpact remains a core portfolio holding due to its solid market position, strong recurring revenue streams, and high switching costs due to providing customized solutions pursuant to three to seven-year contracts. We also believe Genpact's stock is attractively priced.

In terms of portfolio changes during the quarter, we initiated a new position in ULTA Beauty, an omni channel retailer of cosmetics, fragrances, hair care, and skin care products. We like the company's well-known brand, its solid market position, strong customer loyalty program, and the potential for overseas expansion.

During the quarter, we liquidated positions in Expeditors and ResMed. Expeditors is a third-party logistics provider offering its customers air freight, ocean freight, and customs brokerage services. The stock was sold for valuation reasons.

ResMed designs and manufactures equipment used to diagnose, treat, and manage respiratory diseases such as sleep apnea and COPD. We exited the position due to the long-term negative impact, the widespread use of GLP-I anti-obesity drugs could potentially have on the company's business as there's a very strong correlation between obesity and sleep apnea.

Throughout the quarter we trimmed our position in Cadence, a producer of software used to design semiconductors. We believe Cadence is a strong company, but the stock became increasingly expensive in the fourth quarter, thus prompting the weighting reduction.

Moving on to our outlook for the economy and equity markets. As is typically the case, there are a number of tailwinds that exist that support that outlook, and there are also a number of headwinds that exist that could pressure economic growth and market performance going forward. In terms of tailwinds, the next two slides indicate the US labor market remains strong. This graph shows the year-over-year change in monthly average hourly earnings going back to 2007. While hourly earnings growth declined recently, it remains well above the long-term historical average of 3%.

The graph on slide 12 shows the US unemployment rate going back to the late-1940s at 3.7%, the current unemployment rate is meaningfully lower than the long-term historical average of 5.7%. We believe the strength in the labor market has contributed to strong consumer spending in the US. As a reminder, consumer spending accounts for approximately 70% of GDP in this country. This graph shows that after a significant decline during the pandemic, consumer spending rebounded sharply and has trended up ever since.

The continued decline in inflation is another potential tailwind for the economy and markets. This graph shows the year-over-year change in monthly core personal consumption expenditures. This is the Fed's preferred measure of inflation. The data goes back to 2003. While still above the long-term historical average of 2.1%, inflation declined meaningfully from its recent peak of 5.5%, and this suggests that the Fed's campaign of raising the Fed funds rate to reduce inflation may be over.

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 in 2024 following weakness in 2022 and 2023. Equity prices could respond favorably if these expectations are realized. This table shows how the S&P 500 performed historically in years following a year of 20% plus returns for the S&P 500. For example, going back to 1926, the return on the S&P 500 exceeded 20% in 11 years, or 31% of the time following a year of 20% plus returns. Similarly, the S&P 500 was up more than 10% in 21 years or 59% of the time following a year of 20% plus returns. What does this tell us? It suggests that 2023's strong market performance will not necessarily be followed by sub-par returns in 2024. How does the market perform in presidential reelection years like 2024? This slide indicates that the S&P 500 increased in each of the 16 presidential reelection years since 1944.

In terms of headwinds, the strong market rally in the fourth quarter of last year appears to have pushed equity valuations to relatively expensive levels. This graph shows the monthly forward PE on the S&P 500 going back to 1997. At the end of last year, the forward PE of 21.6 times on the S&P 500 exceeded the historical average of 18 times, and was approximately one standard deviation of above that historical average.

Another headwind for the economy and markets is the inverted yield curve. Slide 19 shows the difference between the yield on ten-year and two-year treasuries going back to 2009. Historically inverted yield curves have been relatively good predictors of recessions as shown on the next slide. This slide shows the relationship between yield curve, inversions and recessions. The vertical gray bars represent recessions and the graph line shows the difference between the yield on ten-year and two-year treasuries. When the line falls below zero, the yield curve is inverted. This graph indicates a relatively high correlation between yield curve inversions and recessions.

Slide 21 shows the number of corporate bankruptcy filings through November for each of the years presented. As you can see, year-to-date through November of 2023, corporate bankruptcies increased sharply from 2022. And with the exception of 2020 when the pandemic negatively impacted the economy, bankruptcies are at a 13-year high.

Another data point suggesting the economy may weaken is the Conference Board's Leading Economic Index or LEI. The LEI is designed to signal peaks and troughs in the economy, and it is based on a number of economic indicators including building permits, manufacturing orders, and consumers' expectations for business conditions. As you can see, the LEI remained weak in recent months, suggesting sluggish growth is on the horizon.

The next slide shows GDP growth over the past five years and GDP growth forecast from various economists for the time period 2023 to 2026. As you can see, 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 three years.

In conclusion, as indicated in past webinars, we believe it is very difficult to predict the short-term direction of the economy and markets. The slides reviewed here in this presentation suggest a number of uncertainties exist that could drive the economy and markets higher or lower going forward. Regardless of those uncertainties, we will continue our strategy of focusing on the long term, and investing in undervalued stocks of companies with strong competitive advantages and high returns on capital. We believe this strategy should result in attractive risk adjusted returns throughout the ups and downs of various economic and market cycles.

And with that, we can now open the webinar up for Q&A.

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