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TRANSCRIPT
APRIL 2024

Quality Value Fund Quarterly Update: 1Q 2024

Hosted by Kurt Havnaer, CFA, Portfolio Manager

KURT HAVNAER: Hello, my name's Kurt Havnaer. I'm one of the portfolio managers on the Jensen Quality Value Fund. I'd like to welcome you to our webinar for the first 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 discuss our outlook for the remainder of 2024, for the economy and equity markets. Finally, we'll open up the webinar for Q&A.

Before jumping into performance, we'd like to provide a brief overview of our firm and the investment philosophy for the Quality Value Strategy. Jensen was founded in 1988. The firm is owned by approximately half of our current employees. We manage $13.4 billion in assets in three primary investment strategies: the Jensen Quality Growth, Jensen Quality Value and Jensen Global Quality Growth Strategies.

In terms of our philosophy, we believe undervalued stocks of high-quality companies represent attractive investment opportunities. We define a high-quality company as one that has strong competitive advantages. If a company has strong competitive advantages that should enable it to 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 Quality Value Fund 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 net returns over various time periods through March 31, 2024. As you can see, the fund underperformed its primary benchmark, the Russell Midcap Index, during the first quarter and over the last 12 months, but outperformed over the past three- and five-year periods.

The next slide compares the fund's first quarter gross returns to the Russell Midcap Index. With a positive gross return of 8.61%, shown in the last row of the table on the left, the fund performed in line with the Midcap Index return of 8.6%.

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clientservices@jenseninvestment.com
800.221.4384

From a sector standpoint, the fund's underweight in Real Estate and Communication Services and overweight in Industrials and Consumer Discretionary, were the largest sector contributors to relative performance. Our underweight in Financials and Energy 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 first quarter performance. We can discuss any of these 10 names during Q&A, but we will review Williams-Sonoma and Crown Holdings on the next two slides.

Williams-Sonoma was the fund's top individual stock contributor to performance during the quarter. The company is a specialty retailer of home products with well-known brand names, including Pottery Barn, West Elm and Williams-Sonoma. We believe this stock performed well during the first quarter due to the company generating revenues and earnings in excess of market expectations. We continue to maintain a meaningful position in Williams-Sonoma due to the company's strong brand, reputation for selling high-quality products and economies of scale versus smaller competitors. It should be noted, however, that we recently reduced our weighting in the name due to the stock's strong performance.

Crown Holdings was the fund's largest individual detractor from performance during the quarter. The company manufactures aluminum beverage cans, food and aerosol cans, as well as products such as straps and films that are used to protect cargo loads during transportation. We believe the stock underperformed due to the company missing quarterly revenue and earnings expectations and providing 2024 guidance that fell short of market estimates.

Crown's results are currently suffering from weak aluminum can demand, particularly in Europe and Asia, as consumers in those regions continue to struggle with inflation. We believe these challenges are short term in nature, and Crown remains a top holding due to the company's strong market position, high customer switching costs and continued aluminum can share gains versus glass and plastic due to aluminum's superior environmental profile. We also believe Crown's stock is attractively priced.

In terms of portfolio changes during the quarter, we initiated new positions in MSCI and ON Semiconductor and liquidated Cadence Design Systems.

MSCI provides market index data, performance attribution software and ESG-based data to investment professionals. We like the company's solid market position and high switching costs, recurring revenues and client retention ratio. We also believe the stock is attractively priced.

ON Semiconductor produces semiconductors primarily for the automotive, power generation and industrial end markets. We like the company's global scale, high switching costs and barriers to entry in the industry stemming from the capital-intensive nature of the business. We also like the stock's valuation.

Cadence, a producer of software used to design semiconductors, was liquidated primarily for valuation purposes.

Moving on to our outlook for the economy and equity markets for the remainder of 2024. As is usually the case, there are a number of tailwinds that support that outlook, and a number of headwinds exist 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 recently, it remains well above its historical average of 3.1%.

The graph on slide 12 shows the U.S. unemployment rate going back to the late 1940s. At 3.9%, the current unemployment rate remains well below the long-term historical average of 5.7%.

The continued decline in inflation is arguably another tailwind for the economy and market. 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 from its recent peak.

Another tailwind is the expected improvement in corporate earnings. Slide 14 shows that earnings growth for companies in the S&P 500 is expected to pick up in 2024 and 2025 following weakness in 2022 and 2023. Equity prices should respond favorably if these expectations are realized.

The quote on slide 15 indicates that stocks historically perform well in presidential reelection years like 2024. Specifically, the S&P 500 increased in each of the 16 presidential reelection years since 1944.

In terms of headwinds, the strong market rally that started 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 on the S&P 500 going back to 1997. At the end of the first quarter of 2024, the forward P/E of 22 times on the S&P 500 exceeded the historical average of 18 times and was slightly greater than one standard deviation above that historical average.

Another potential headwind is the significant decline in the personal savings rate to 3.6%, which is meaningfully below the historical average of 8.5%. This suggests that consumers may not have much left in the tank to keep driving spending higher going forward.

The next slide shows the year-over-year change in household debt recently dropped to 3.6%, which is lower than the historical average of 4.3%, and significantly below the 8%-plus levels reached in 2022. This graph suggests that consumers could be approaching the point where they are increasingly unwilling to fund expenditures with additional borrowings.

Slide 19 indicates how expensive it has become for consumers to borrow money as interest rates increased over the past few years. The significant increase in credit card and auto and personal loan rates could pressure consumer spending going forward.

Slide 20 shows the ratio of household debt service payments to disposable personal income going back to 1980. While the most recent reading of 9.8% is below the historical average of 11.1%, the ratio increased sharply since 2021. Should this trend continue, consumer spending is likely to be negatively impacted.

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

Switching gears to corporate America, slide 22 shows the number of corporate bankruptcy filings in the U.S. going back to 2010. As you can see, corporate bankruptcies of 637 in 2023 increased sharply from the preceding two years, exceeded the 14-year average of 561 and were essentially even with 2020 when the pandemic negatively impacted the economy.

The next slide shows GDP growth over the past six years and forecasts from various economists for 2024 to 2027. As you can see, GDP growth is expected to decline in 2024 and to remain below the 50-year average of 2.7% in each of the next four years.

To conclude, as we've mentioned in previous webinars, we believe it is very difficult to predict the short-term direction of the economy and equity markets. As outlined in the preceding slides, a number of uncertainties exist that could drive the economy and markets higher or lower going forward. Regardless of 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.

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

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

jenseninvestment.com