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TRANSCRIPT
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Quality Growth Fund Quarterly Update: 2Q 2025

Hosted by Allen Bond, CFA, *Managing Director, Head of Research & Portfolio Manager*, and Kimberlee Millar, CFA, *Business Analyst*

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

So on the next slide, we have an 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, and is currently owned by 24 active employees out of a total of 38 employees. Across the firm we manage a bit less than $9 billion across our three strategies. The first is Jensen Quality Growth, the purpose or the focus of the call today. It is a large-cap equity strategy, focused on the long-term ownership of high-quality value trading businesses. It was launched with the founding of our firm in 1988 and has been available as a mutual fund since 1992. It is very much our flagship strategy and accounts for the vast majority of our assets under management.

The second strategy is Jensen Quality Mid Cap. It is a mid-cap strategy focused on investing in mid-size high-quality businesses. The composite for the strategy was launched in 2008, the mutual fund was launched in 2010, and the strategy was essentially rebooted in 2017 to focus on the fundamental business research that is similar to that in the Quality Growth Strategy. Today, the Mid Cap Strategy is very similar to Quality Growth, but with a focus on mid-size businesses.

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Lastly, we have Jensen Quality Global. This is very much an extension of the domestic Quality Growth Strategy, but with an expanded investable universe that includes companies domiciled overseas. The strategy was launched in April 2020, and this year achieved its five-year investment performance track record.

On the next slide, we have an overview of our investment philosophy, and there's a lot here on the slide, but the simple way to sum it up is to say that we seek to invest for the long term in businesses that grow and create business value, and as a result we focus our research on factors that we believe are linked with sustainable business value creation. These include competitive advantages, free cash flow, financial flexibility and business model consistency. It's also important that we identify growth drivers for us, that's not always explosive growth, but more a focus on steady 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 invest when shares trade below our estimate of full value. And for us, the importance of valuation is really twofold. The first is to provide a margin of safety against any unforeseen pricing risk. The second is that if we pay a fair price for a stock, the chances of the stock price tracking alongside business value creation is higher, and helps us to achieve our goals. The result here, in our view, is a portfolio of high quality and fairly valued stocks.

With that, I will turn over the call to Kim to discuss quarterly investment performance and portfolio changes.

KIMBERLEE MILLAR: Thanks, Allen. We will begin with a review of the historical investment performance of the Jensen Quality Growth Fund. After a strong start to the year, the fund underperformed its S&P 500 benchmark in the second quarter. This recent stretch of weaker results has also weighed on longer-term relative performance. On the next slide, I'll highlight the key drivers of second quarter underperformance, beginning with a look at the market style dynamics, followed by a deep dive on sector and stock level attribution.

Style factor performance analysis helps explain what types of stocks, like growth, value or quality drive market returns. Last quarter, market gains were led by high-growth, high-volatility and momentum-driven stocks, while high-quality stocks, Jensen's area of focus, lagged. Although this environment posed a headwind to our approach, we remain disciplined, selectively adding high-conviction quality growth names to the portfolio. This positions the portfolio to participate in future upside, while staying aligned with our longer-term investment philosophy and risk framework.

So moving on to performance attribution, this chart shows how the portfolio's performance compared to the S&P 500 Index during the second quarter, with the relative return broken down into the effects of sector allocation and stock selection. Starting with the bottom row, the portfolio returned 4.13% compared with the benchmark's return of 10.94%. The final three columns isolate the drivers of relative performance. Sector allocation, shown in the third column from the right, contributed positively to returns. If you look at the middle column, which shows benchmark returns by sector, you'll see significant dispersion: Information Technology gained nearly 24%, while Energy and Health Care declined by 9% and 7%, respectively. The portfolio benefited from our overweight in Information Technology and from not owning any Energy stocks, though this was partially offset by an overweight in Health Care. The primary driver of underperformance was stock selection, shown in the second column from the right. I'll highlight three sectors with the most negative stock selection impact.

Industrials was the weakest area. Copart, an online salvage vehicle auction operator, was the largest detractor following disappointing quarterly results. Information Technology was the second-largest drag. Our overweight in Accenture weighed on results due to weaker federal bookings amid tighter government IT budgets. In addition, our underweight in mega-cap tech including Nvidia detracted meaningfully. That said, Amphenol and KLA, both overweight positions, outperformed the broader technology sector, and helped offset some of the weakness.

Lastly, stock selection in Financials also detracted. Marsh & McLennan pulled back after strong first-quarter gains, as insurance stocks came under pressure on concerns surrounding softening property and casualty pricing trends.

Next, I'll highlight Microsoft. This is our largest portfolio holding and the top contributor to absolute returns in Q2. The company is a global leader in productivity software, cloud computing and enterprise services. Its broad integrated product suite is essential to most businesses, creating high switching costs and a strong lasting competitive advantage. The stock performed well during the quarter, supported by continued momentum in its Azure cloud platform and rising demand for AI capabilities, which are fueling broader enterprise investment in cloud infrastructure. Microsoft's strong market position and disciplined leadership have allowed it to invest consistently in long-term growth. This gives us continued confidence in Microsoft as a reliable long-term compounder in the portfolio.

On the other end of the spectrum, we have UnitedHealth Group. UnitedHealth Group was the largest detractor from absolute returns last quarter. The company operates a diversified healthcare platform spanning insurance and services. Shares declined sharply following earnings, driven by elevated medical cost trends, particularly within its Medicare Advantage segment. Execution missteps in plan pricing and benefit design left the company vulnerable to a more challenging utilization and reimbursement environment. Adding to this were growing concerns around regulatory scrutiny of billing practices. Shortly after the earnings release, United withdrew its financial guidance and announced the CEO's departure, further weighing on investor sentiment. Given the reduced earnings visibility and diminished confidence in management's ability to navigate these challenges, we exited the position.

Now I'll discuss notable portfolio changes during the quarter. We initiated positions in three new companies. First up is Eli Lilly. Lilly is helping redefine the treatment landscape for obesity and Type 2 diabetes through its next-generation GLP-1[1] therapy. The company has already captured meaningful share in the diabetes market, while obesity, a significantly underpenetrated category, represents a major long-term growth opportunity. Although public and investor interest in this space has surged, our analysis suggests the opportunity remains in its early stages. Pricing headlines and competitive developments may introduce near-term volatility, but Lilly's clinical differentiation, strong execution and capital discipline position it well to sustain leadership. A robust pipeline, including next-generation obesity therapies and early stage assets in oncology and neuroscience, reinforces our conviction in its potential for sustained innovation. We view Lilly as one of the most compelling opportunities in global healthcare.

Next up is Meta, another well-known name. Meta owns Facebook, Instagram, WhatsApp and Messenger, platforms with over 3.4 billion daily users. This scale drives powerful network effects: as more people use the platform, their value increases for both users and advertisers, reinforcing Meta's leadership and establishing high barriers to entry. Meta also stands out for its AI leadership, especially with its open-source Llama models, which improve user experience and ad performance. It has strong competitive advantages, generates solid free cash flow and has a history of reinvesting in its core business with a long-term focus.

Finally, we added a position in Nvidia, a global leader in the chips and technology powering artificial intelligence. The company plays a critical role in the AI ecosystem, with both the hardware and software tools that developers rely on giving it a strong competitive edge.

Nvidia became eligible for our portfolio in mid-2024 after meeting our return on equity criteria, and we took advantage of market volatility in early April to initiate the position at an attractive valuation.

Now turning to how we funded these new positions, starting with Pepsi. We exited Pepsi due to uncertainty around its long-term growth outlook, particularly given the structural risks posed by GLP-1 therapies, which suppress appetite and could pressure its snacks and sugary beverage categories. While Pepsi maintains strong global scale and brand equity, the broader trend toward healthier, less processed foods and persistent volume softness in key markets reduced our conviction. We reallocated capital to businesses with stronger growth drivers.

Another name we exited is Nike. Nike remains a global brand leader, but recent missteps including a difficult transition to direct-to-consumer sales, intensifying competition, and underinvestment in innovation have weighed on performance. While we have previously anticipated a recovery by 2026, growing tariff-related risks and prolonged execution challenges prompted us to exit the position in favor of opportunities with more certain growth outlooks.

Finally, we also exited Texas Instruments. This decision was driven by a weaker growth outlook tied to cyclicality

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

in its core industrial and automotive end markets. While Texas Instruments remains a high-quality business, we saw a more compelling long-term risk-reward profile in Nvidia, whose exposure to secular AI-driven growth offers greater potential than Texas Instruments' more cyclical demand drivers. And with that, I'll hand it back to Allen.

ALLEN: Thank you, Kim. Moving on to our outlook, we list here a number of uncertainties that are currently facing investors. And in our view, the resolution of these uncertainties could drive market sentiment here in the short and intermediate term.

The first thing we want to talk about is risk. Consistent with Kim's comments, risk was back in favor in a big way in the second quarter. That occurred after what appears to be a brief risk-off period in early 2025, and the second quarter trends marked a resumption of a three-year pattern. The key uncertainty here is, how long will this risk appetite persist?

The second uncertainty is around the artificial intelligence trade, and Kim has alluded to some of the ways we've positioned the portfolio relative to this trade recently. But the key uncertainty is how long this trade can last, and we think this theme and this growth opportunity is the primary driver behind the risk-on sentiment that we've seen from investors.

The next is just about index earnings. This is always critical to support future stock price advances. And right now we do expect earnings to increase this year and next, but the uncertainty is really about the direction. Do those estimates go higher or lower, and how are they updated based on the outlooks that were given during second quarter earnings season?

Lastly, there's uncertainty about tariffs, and this is obviously the key uncertainty that led to a real spike in volatility early in the second quarter. Right now we know that tariff revenues are higher, but we also know that a lot of the individual tariff deals and negotiations have not been finalized. And so the key uncertainty here is, what ultimately do these tariff deals look like and how will that impact the economy? And most critically, how they might impact inflation.

And then lastly, I want to offer a few high-level thoughts on portfolio activity. It was definitely higher than normal during the quarter, and Kim touched on some of the details, but there's a conversation to have more thematically about what did we change and why.

On the next slide, we start our overview of risk and we have several slides over different measures and different time periods to make the case and illustrate just how much of a risk-on environment we saw in the second quarter. On this slide, we have a graph of the movements of the CBOE volatility index, so far here in 2025. As a reminder, this is commonly called the VIX index, and it represents expected volatility in the S&P 500 index based on put and call activity. And as you can see by this measure, stock market volatility peaked in early April and declined precipitously thereafter. This change is largely consistent with the market factor chart that Kim discussed earlier for the quarter.

On the next slide, we have another lens on risk, and in this case we are using the Bloomberg Bitcoin Index. As we know, Bitcoin is a lot of things, but it is often thought of as a risk asset and a good proxy for measuring investors risk appetites. And as a reminder, this index is provided by Bloomberg, it measures the performance of one Bitcoin traded in U.S. dollars. As you can see on the chart, the index bottomed in early April, alongside the spike in volatility that we showed in the last chart, and has rallied back in the second quarter alongside other risk assets. This is one more data point that indicates a risk on sentiment that was pervasive in the second quarter.

Next slide is even a shorter-term time period, and this analyzes risk appetite over the past 65 days. It was created by economic research from Strategas. It shows the pattern between high-beta and low-beta stocks. The key takeaway here is that high-beta stocks were favored at historically high levels relative to low-beta stocks during this period. And in fact, this trend, the most recent tick shows this favoring high-beta stocks in the 99th percentile relative to low-beta stocks. Yet another data point corroborating the risk-on sentiment that we've seen here in the most recent quarter.

On the next slide, this is our final look at risk, and this is going to back it out and look at it over the last three years, which is obviously a much longer time period. You may also recognize this slide because it's very similar to what Kim showed that talked about factor analysis in the most recent quarter, and what you can see here is very similar to what Kim discussed. In the last three years, growth has been in favor, volatility has been in favor, momentum has been in favor. Quality has largely been out of favor. That's a factor that our strategy is heavily over indexed towards. Other factors including valuation and cash flow were also out of favor during this period. And the reason we think this is important to show, is that there's no denying that our strategy has been out of favor in this last three-year period as well. But this backdrop, this pervasive risk-on sentiment, that really in a lot of ways was felt, and is corroborated here in the chart, is that the "growth at any price, volatility doesn't matter" type of trade has been pervasive.

And in our experience, trying to understand when these sentiments are going to change is very difficult; they often happen quickly. We saw that in the first quarter; we saw sentiments change and this picture looks very different, but now we're back on. In our view, our expectation is that the sentiment will change again. And as we talk about portfolio positioning a bit later, this is something that we do think about, in terms of how we position the portfolio as positioned for today, but also positioned for future uncertainties. Because we know this can happen quickly, it can happen capriciously, and is often only evident in hindsight. So we want to be positioning the portfolio over the long term for potential changes.

Next slide. I mentioned artificial intelligence, and in our view this trend and this theme has been the primary driver of the risk-on sentiment that we've seen for the past few years. This slide is a chart from McKinsey & Company, which is a leading consultant, and it illustrates expectations for data center capacity. And here they're using gigawatts of power consumption as the measurement. The idea here is that data center growth and data center investment is a good proxy for artificial intelligence investment, and just computing investment in general.

Data centers use a lot of power, and so the gigawatts of power consumption is a good way to measure that investment theme. As you can see, data center investment spending is expected to grow rapidly over the next five years, and primarily driven by AI-related growth. And that's the primary growth driver of data center investment spending. In total, and this is not shown in the chart, but McKinsey predicts that AI software and services could produce an overall economic impact of more than $3 trillion annually over time. And for context, U.S. GDP is currently running at about $30 trillion, so this is definitely a meaningful impact.

This chart, and there's many others that are like this, really provides the support and the backdrop for the investment themes that we've been seeing. And in our view, this expectation is largely being priced into stocks or has been priced into stocks, but it's important because it supports a lot of the growth and a lot of the optimism we've seen from investors.

On the next slide, we're going to talk about shorter-term themes and shorter-term corroboration. And what we're showing here is commentary from the "hyperscalers" from the first quarter earnings seasons. As a reminder, hyperscaler is a term that gets thrown around a lot, generally thought of as a company that provides cloud computing infrastructure at massive scale, operating data centers and offering services like computing, power storage and networking. Investment spending from these companies can often be thought of as a proxy for AI infrastructure. Generally speaking, Microsoft, Google and Amazon are thought of as the three largest hyperscalers. And as you can see, all three of them during the last earnings season either confirmed or increased their expectations for spending on data centers. We think this confirmation was a key driver of the growth we saw in the market during the second quarter because of the indication of a healthy spending environment.

As we look forward to the next quarter, we think similar comments from these companies are going to be critical in determining the direction of the markets and the enthusiasm for this continued trade. And you can think of it as kind of an interim check-in on those longer-term trends that we showed on the last slide.

Moving on to the next uncertainty in terms of trade policy. As we know, this uncertainty was a key driver of the market volatility that we saw early in the second quarter. This chart shows the trend in tariff revenue that's collected by the U.S. Treasury over the past 10 years. As you can see in the chart, monthly tariff revenue surged in the months following the Liberation Day tariff announcements, and is now running at orders of magnitude higher than where they have been in the past. The takeaway here is, despite the fact that the initially announced reciprocal tariffs were paused or walked back, import taxes are still significantly higher than in recent history, and are no doubt having an impact on the economy.

On the next slide, we show expectations as these trade policy negotiations are finalized, and this is the key uncertainty that we're faced with as investors. The ultimate impact of the change in trade policy is going to have determinations on corporate profit margins and inflation. So far, investors, with the exception of early April, have largely looked through this uncertainty and focused on these other growth drivers that we've talked about, and that has allowed the market to re-advance to new highs. But we do think the ultimate impact of tariffs will be a key topic during the upcoming earnings season. And company outlooks and company commentaries on this topic will have the potential to change market sentiment.

On the next slide we show inflation historically. And the conventional wisdom is that tariffs should be inflationary, because companies will raise prices to offset additional import taxes. However, at present, as you can see, there's very little indication of a surge in inflation. The key uncertainty here is whether or not there will be a lagged impact from tariffs, once perhaps inventories are depleted and companies have to face a new reality. But, so far, we haven't seen that impact. We do expect this to be another key focus area for investors during the upcoming earnings season as companies provide guidance and outlooks.

On the next slide we show expectations for Fed policy. We know the Fed pays very close attention to inflation, and certainty about this inflation appears to be the key factor preventing the Fed from enacting further rate cuts. As you could see in this chart, the Federal Open Market Committee last reduced the Fed funds rate in December of last year, but it's been on hold thus far in 2025. And as you can see, investors expect further reductions to the Fed funds rate, but these reductions have been postponed. If we go back a few months ago, the expectation was that the Fed would reduce rates in June. Well, June has come and gone and nothing happened there. Now the expectation is that maybe, in September is a live meeting, and they'll reduce rates. But the direction and the outlook from the Fed, which in our view is going to be informed by inflation, is a key uncertainty that, as a result, could have an impact on market sentiment.

Next slide is earnings. It is almost impossible to have an outlook without looking at earnings because earnings are a key support for market advances. As you can see here, earnings are expected to advance over the next 12 to 18 months. We do think this provides support for further market advances, but like anything else, the directionality and how those estimates change is what we expect will impact market sentiment. And again, these estimates could change based on guidance and outlook we get during the upcoming earnings season.

Now to our last chart. This shows year-to-date movement in the S&P 500 and so it's fairly self-explanatory. But as you can see, the index recently attained new highs after a period of meaningful volatility early in the year. We also included a note related to portfolio activity, and that can provide some context to Kim's commentary on portfolio changes.

And so I think it's important to start out at a high level. We intentionally manage the Quality Growth Strategy with a long-term mindset. This typically results in low portfolio turnover. However, the second quarter was a bit of an exception. We had a bit higher than normal portfolio activity, and this was largely due in response to market volatility. So as many of you know, the majority of our trading activity comes out of a quarterly review process of the portfolio that we go through. We evaluate the portfolio on our own terms after earnings are reviewed and models are updated, and we go name by name to make determinations about the portfolio. And this is something we've been doing for a long time and drives the typical amount of our trading activity.

However, we did have a special meeting in that area we circled here at the bottom. What we saw in early April was what appeared to be indiscriminate market selling, and we viewed that as a potential opportunity to upgrade the portfolio and do so at attractive prices. The thought being that, with an indiscriminate selling environment, all stocks are on sale. So the best ones and the worst ones, and there was a number of stocks, and Kim mentioned Nvidia as a perfect example of a business that we think is phenomenal, and we wanted to make sure that we got in at a good entry point and thought this was an opportunity. So the most visible outcome of this interim review was the addition of Nvidia to the portfolio. We think we were able to put in what we view as a very high-quality business at an attractive price, which is important to us because Nvidia is, in our view, a great business. We think the stock is fairly priced, but it's also a very volatile stock. So again, we talk about margin of safety, and this is where this kind of thing is very important.

We added other, we think are very well positioned, technology companies, at what we think were discounted prices in that period. This was also the time where we exited positions in Nike and Texas Instruments. So again, as Kim mentioned, conviction had waned on the near-term outlook for those businesses, and we thought we had the chance to upgrade the portfolio, again at attractive prices. I think the takeaway here from this is that we certainly aren't market timers in the short term. We don't intend to be, we certainly weren't trying to bottom tick the market here. But we do monitor things all the time, and we do have an active bench. And when we saw an opportunity to add high-quality businesses to the portfolio at attractive prices, we decided to proactively take that opportunity.

So in closing, our goal is to own businesses that we believe are uniquely well positioned to grow and create business value. We think it's important as long-term investors that we own these businesses at reasonable prices. We think this approach has helped us improve the quality, growth and valuation profile of the portfolio over the past three months, positioning the portfolio for today, but also for the future in terms of the quality and the growth outlook of the portfolio.

In closing, we would like to thank you and your clients for your business and confidence in the Quality Growth Strategy. We do not take that for granted. And we certainly do not take that for granted in the current environment where recent-term investment performance has lagged.

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