TRAN CAPITAL MANAGEMENT

Multi -Cap Growth Equity | First Quarter 2021

Dear Clients,

We hope this letter finds you healthy and well. It's been a remarkable year for our country and much has changed since our first quarter update one year ago. As we stand at the cusp of a return to normalcy with the U.S. ramping towards 3 to 4 million vaccine shots per day, we'd like to take a moment to first acknowledge the heroic work of our healthcare workers, front-line workers, and every Agency that helped us meet the magnitude of the moment. We also shouldn't forget the unimaginable number of lives and businesses that were lost far too soon. Our collective responses and actions were not perfect – they seldom are during periods of crisis – but it could have been much worse. Through determination, grit, and a lot of trial and error, we are in a better place now than a year ago. There will be lasting effects from COVID-19 and certain prior routines will have changed forever, but at least we can resume much of our activities and move forward.

Our firm is also moving forward with a new name. Four years ago, we led a management buyout and recapitalization of Lateef Investment Management. At the time, Eric Winterhalter, McCarthy Capital, and I believed that we could build a lasting investment firm that focused on generating outstanding returns while being responsive and attentive to you, our clients. In doing so, we founded a new firm that not only appreciates our heritage, which dates to 1974, but also moves forward with our new Partnership. We are proud to announce that our firm is now named **TCM – TRAN CAPITAL MANAGEMENT**. Rest assured that there is no change in our team or process. Today's move serves as recognition of our team's hard work and accomplishments as well as the aspirations we hold to continue to deliver on behalf of our clients in the dynamic capital markets of today and tomorrow.

While our name has changed, our pledge to our clients remains the same:

- We will always act in our clients' best interests.
- We will always invest with conviction.
- We will continue to execute and build on the enhancements we have implemented since our buyout.
- We will have strict capacity limits and not become asset gatherers.
- We would rather double our clients' capital than double the number of clients.
- We are committed to a high-functioning, collaborative, diverse, and sustainable investment culture.

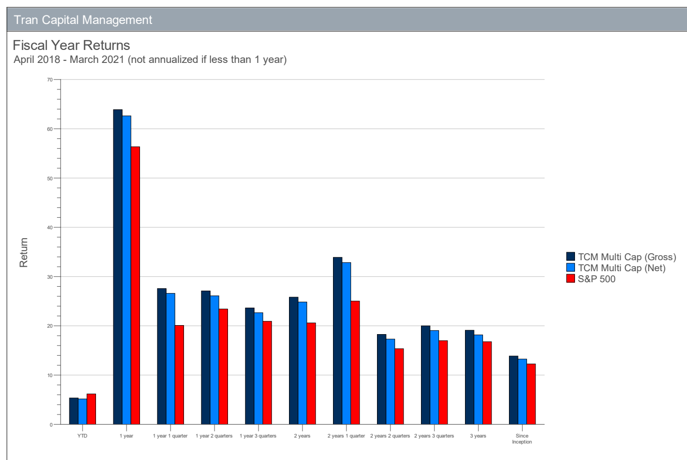
We are grateful for your confidence and support. Without it, TCM would not have been possible. Since the formation of this partnership four years ago, we have been able to generate strong returns by investing in high-quality growth companies and actively rotating into many of our "wish list" companies during periods of volatility and market drawdown. We don't know how the market will behave in the short term, but experience has taught us that, over time, investing in leading companies purchased at favorable prices can lead to attractive returns. **We believe the volatility during the first quarter gave us many such opportunities.**

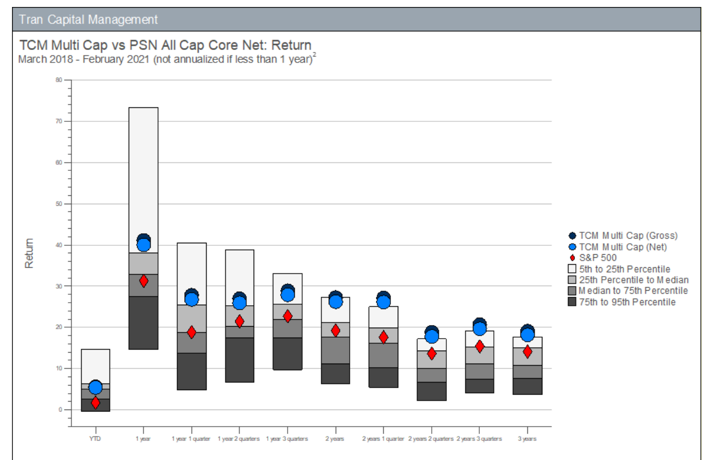
TCM's Multi-Cap Strategy returned 5.16%, net of fees, versus 6.18% for the S&P 500 in the first quarter and 62.62% net of fees versus 56.35 for the trailing one year. As we reflect on our portfolio's performance since our management-led buyout in 2017, we would like to

highlight that our focus on identifying growing companies purchased at reasonable valuations has enabled us to keep up during market rallies and go down less in periods of market drawdown.

Our investment approach also gives us the flexibility to invest in *growth* and *value* companies as long as we believe a company's growth profile and fundamental improvements are not adequately reflected in its stock price. For instance, during the first quarter, **Wells Fargo (WFC)** and **Southwest Airlines (LUV)**, both considered *value* companies, appreciated approximately 30% each. These gains help offset weakness in some of our more *growth* investments like **Palo Alto Networks (PANW)** and **Salesforce (CRM)**, which fell 10% and 5%, respectively.

By being grounded in valuation, we may miss some popular stocks, but we would also avoid the harm when these stocks come back down from their atmospheric valuations. Rather than chase popular stocks, we often initiate positions when our target companies are out of favor. **We believe that this disciplined investment approach has enabled us to be in the top 5% of our All-Cap Core peer group since our buyout.**[1] As shown below, our team has generated significant returns net of fees in excess of the S&P 500 over this period.





WE BELIEVE THAT THIS DISCIPLINED INVESTMENT APPROACH HAS ENABLED US TO BE IN THE TOP 5% OF OUR ALL-CAP CORE PEER GROUP SINCE OUR BUYOUT.[1]

Taking Advantage of Drawdowns

We observe that there were a couple significant market events that contributed to the first quarter's choppiness. First was the enthusiasm for popular social media driven short squeezes, like GameStop, that led to an unwinding of positions and sharp risk-off behavior at the end of January. Second was the unraveling of institutional and, moreover, retail enthusiasm over speculative tech and sky-high valuations as fears of oncoming inflation led to a rise in interest rates, even despite the Fed's continued stance of "lower for longer."

Outside of the GameStop's (ongoing) rollercoaster, investor fervor and rich multiples led to a flood of private companies going public via special purpose acquisition companies (SPACs). While there are certain advantages like speed to market, there are also disadvantages to investors such as a lack of transparency, financial scrutiny, and potentially misaligned incentives. Despite the media's enthusiasm for

[1] Source: TCM versus PSN All Cap Core managers on 3-year basis, manager returns supplied by Informa Investment Solutions, Inc. via APX Stream, Inc.

[2] The universe information shown is the most recent published data as of the writing of this letter through February 2021.

these stocks, we have generally avoided these speculative areas of the market given little diligence, potentially untested business models, and the market's recent history of bidding up SPACs based on rumors. We would note that **Clarivate (CLVT)**, one of our top performers last year, became public via SPAC; however, in the case of Clarivate, the merger had been completed and it was for a durable and highly recurring business model led by a proven CEO.

Later in the quarter, equity markets were rattled as strong U.S. economic activity and oncoming fiscal spending raised concerns of rising inflation that triggered a move in interest rates. The 10-year U.S. Treasury yield increased from roughly 1.0% at the end of January to a high of 1.74% at the end of the quarter. Led by high multiple tech stocks, rising interest rates sparked a broad market selloff that saw the Nasdaq Index decline ~12% from February 12th to March 8th and the S&P 500 decline ~6% from February 6th to March 4th.

Our investment team is mindful that an even steeper rise in inflation expectations and interest rates can further damage equity valuations, but we agree with Federal Reserve Chairman Jerome Powell that an increase in inflation will likely be transitory. Moreover, we believe the U.S. economy will need some time to absorb the over 10 million people who are still unemployed or under-employed. As such, we do not believe that the Federal Reserve will raise interest rates until we have full employment and that the Federal Reserves will let inflation run above average for a while. While interest rates could continue to move upwards ahead of Fed policy, we observe that **the S&P 500 has had a strong track record during periods of rising interest rates, especially when supported by strong economic growth**.

Start Date	End Date	Duration	10-year Yield Start	10-year Yield End	Change in 10-yr Treasury Yield	S&P 500 Price Return
12/26/1962	8/29/1966	44M 3D	3.8%	5.5%	1.7%	18%
3/16/1967	12/29/1969	33M 13D	4.5%	8.1%	3.6%	1%
3/23/1971	9/16/1975	53M 24D	5.4%	8.6%	3.2%	(18)%
12/30/1976	9/30/1981	57M 0D	6.8%	15.8%	9.0%	9%
5/4/1983	5/30/1984	12M 26D	10.1%	14.0%	3.8%	(8)%
8/29/1986	10/16/1987	13M 17D	6.9%	10.1%	3.2%	12%
10/15/1993	11/7/1994	12M 23D	5.2%	8.0%	2.9%	(1)%
1/19/1996	7/8/1996	5M 19D	5.5%	7.1%	1.5%	7%
10/5/1998	1/21/2000	15M 16D	4.2%	6.8%	2.6%	46%
6/13/2003	6/28/2006	36M 15D	3.1%	5.2%	2.1%	26%
12/30/2008	4/5/2010	15M 6D	2.1%	4.0%	1.9%	33%
7/24/2012	12/31/2013	17M 7D	1.4%	3.0%	1.6%	38%
7/8/2016	10/5/2018	26M 27D	1.4%	3.2%	1.9%	35%
3/9/2020	2/25/2021	11M 16D	0.5%	1.5%	1.0%	39%
8/4/2020	3/31/2021*	7M 27D	0.5%	1.7%	1.2%	20%
				Average	2.9%	17%
				Median	2.4%	15%
				Periods Positive Return		11
* Ongoing. Exduded from Average, Median, & Period Figures				Periods Negative Return		3

Source: Bloomberg

With this view in mind, we attempted to take advantage of the intra-quarter market selloffs to invest in several high-quality companies that have been on our "wish list". We believe each of these companies has a strong moat and are improving their competitive positions and services to their customers.

During the meme stock driven drawdown, **Disney (DIS)** sold off over 12%. We have owned Disney in the past and have admired how well Disney has pivoted its business to address the secular shift from traditional distribution (cable and satellite partners) to on-demand and streaming, specifically by distributing its best-in-class content through Disney+, its own direct-to-consumer streaming platform. As

of March, Disney+ has captured over 100 million digital subscribers within just 16 months of launch. We believe Disney's scale and unmatched catalogue of intellectual property will allow it to be one of the long-term winners in the direct-to-consumer streaming market. Moreover, our analysis suggests that in a few years, Disney+'s growth in revenue should outpace its growth in content spend as the platform reaches scale. In other words, Disney is poised to see margin expansion from its streaming services.

In the meantime, Disney is also a re-opening beneficiary given the tremendous amount of pent-up demand for leisure travel and entertainment following a year plus of sheltering in place. Disney's theme parks, hotels, cruise ships, and theatrical revenues should all benefit from a likely strong surge in consumer spending on experiences. Given the company's pricing power, Disney should continue to be successful in raising prices to offset inflationary pressures.

Another wish list opportunity we added was **Amazon (AMZN)**. Jeff Bezos wrote in Amazon's 2016 annual letter that for Amazon, *"Day 2 is stasis. Followed by irrelevance. Followed by excruciating, painful decline. Followed by death. And that is why it is always Day 1."* Bezos' words speak to the culture at Amazon of never resting on their laurels. Perhaps there is no better example of this philosophy than by watching how this company repeated turns its biggest costs into leading and profitable businesses.

Amazon's core business is its eCommerce platform which generates close to $500 billion of gross merchandise value each year. Rather than resting on this remarkable achievement, Amazon continues to expand its addressable market. For instance, Amazon's scale and investments in logistics enable the company to offer third-party seller services. Amazon will help list merchandise, warehouse, fulfill product, and handle customer service and returns for third-party merchants. This complete seller solution is more efficient and less expensive than if the seller performed each function themselves. With third-party seller services, Amazon expanded its addressable market and leveraged otherwise internal costs to earn an estimated 20-40% fee on merchandise value. **Amazon's third-party seller services generates a higher profit margin and is also growing faster than Amazon's original first-party eCommerce business**.

AMAZON'S THIRD-PARTY SELLER SERVICES GENERATES A HIGHER PROFIT MARGIN AND IS ALSO GROWING FASTER THAN AMAZON'S ORIGINAL FIRST-PARTY ECOMMERCE BUSINESS.

AWS TODAY GENERATES 30% SEGMENT PROFIT MARGINS AND ACCOUNTS FOR OVER 60% OF AMAZON'S PROFITS.

Another example of Amazon turning a cost center into a high-quality business is Amazon Web Services, or AWS. Here, Amazon leverages its technology investments by renting space on its servers and lending computing power to other businesses. AWS literally created cloud computing-as-a-service. It's no surprise that AWS leads this market with over $45 billion revenues and growth of over 30% a year. **AWS today generates 30% segment profit margins and accounts for over 60% of Amazon's profits**.

Amazon continues to expand into other businesses, including advertising, healthcare services (again leveraging a high internal cost center), and subscription services (Prime, Audible, music, etc.). Amazon is already quickly growing its advertising business within its marketplace ecosystem, enabling merchants with the ability to attract new customers. In 3 years, we believe this advertising business has the potential to become the size of AWS today, if not larger, while also operating at a higher margin and lower capital intensity than AWS. In media, Amazon will now broadcast the NFL's Thursday Night Football games, adding content to its library of shows, movies, and music, all of which strengthen the value proposition of its Prime membership. We view Amazon as having a durable competitive moat that is only getting stronger. As Amazon underperformed more speculative areas of the market, it provided us an attractive entry point to own a company that should continue to grow at an attractive rate for many years.

2020 was a year that accelerated digital transformation. One of the foundational technologies enabling next generation data centers, 5G networks, autonomous driving, artificial intelligence, gaming, and digital currencies is the semiconductor. **Nvidia (NVDA)** is the leader in graphics processing units, or GPUs, with its chips having dominant market share in several growing industries. Whereas CPUs can handle most general-purpose workloads and are optimized for sequential serial processing, GPUs enable parallel workloads that allow for processing of larger data sets in less time while also consuming less power. Traditionally, GPUs were used for rendering 2D and 3D graphics and images, but they are increasingly being used for computationally intensive tasks needed for machine learning and artificial intelligence along with next-generation data centers that are needed to process big data.

Specifically, in PC gaming, Nvidia has a dominant market share (over 70%) where it has a base of 200 million installed PC gamers using its GPUs. Outside of PC gaming, Nvidia also provides GeForce Now for cloud-based gaming, systems-on-a-chip (SoCs) for Nintendo Switch, Shield devices for gaming and streaming, Broadcast for live streaming, and Virtual Reality development platforms. Nvidia's GPUs are also taking share in the increasingly important data center accelerator market where the company's GPUs power 70% of the top 500 supercomputers (and 8 out of the top 10). Every major cloud provider, including AWS, Azure, Oracle, Alibaba, and Google, uses Nvidia's GPU chips. Finally, Nvidia's GPUs are also enabling work in AI where modeling complexity is doubling every two months.

NVIDIA'S MOAT OF A SUPERIOR ARCHITECTURE IS FURTHER STRENGTHENED BY ITS SOFTWARE STACK.

While Nvidia's parallel processing architecture is a step function improvement over sequential processing for large datasets, Nvidia has further differentiated its competitive advantage by building software stacks to complement its GPU chips. In fact, over half of Nvidia's engineers are software engineers. The company's software platform, CUDA, has attracted over 2.3 million developers who in turn have supported over 6,500 startup companies. **As such, Nvidia's moat of a superior architecture is further strengthened by its software stack**. We believe Nvidia's technological foundation will enable the company to grow at a high rate enabled by multiple industry tailwinds for many years. We were excited to add Nvidia to our portfolios after it declined about 20% in March. We believe this will mark an attractive entry point for this secular and cyclical growth company.

Finding Space in the Portfolio

It's becoming increasingly more difficult to find space in our portfolio. However, to fund these new ideas, we had to make room. During the quarter, we sold **The New York Times (NYT)**, **Clarivate (CLVT, formerly CCC)**, **Starbucks (SBUX)**, and **Visa (V)**. While these companies continue to be wonderful businesses with exceptional management teams, we believe their growth prospects were fully reflected in their valuations and our new additions had more attractive upside.

New York Times is a good example of a traditional media company that faced the reality of a rapidly changing landscape and pivoted to a digital subscription model. This took several years, and the work continues. We first purchased shares in NYT in 2018 in the mid-$20s. At the time, the company had 3 million digital subscribers, which was enough to cover all its operating costs. Our analysis suggested that the company could grow to at least 10 million subscribers and that these incremental new subscribers would be very profitable as the company leveraged its content (plus not requiring print and delivery). Additionally, NYT had an opportunity to acquire and build more products for its customers, widening its value proposition and strengthening its recurring subscriptions. We believe that our thesis has largely played out and that these opportunities are reflected in the company's valuation. NYT now has over 7.5 million subscribers across its digital and print subscriptions. We trimmed NYT in 2020 and, with the stock at nearly ~$50 per share, we sold our remaining shares. While we believe there was still some upside in our investment, we viewed other opportunities as being more attractive.

As a quick refresher, **Clarivate** was spun out of Thompson Reuters 2016. We believed Clarivate's healthcare and research databases were best-in-class but needed some management focus to improve the product, user interface, and change the culture from maintenance to growth. Clarivate's highly recurring and free cash flow generative business model would also allow for not just more organic investments but value-enhancing M&A as well. CEO Jerre Stead and his team have done a wonderful job, and we enjoyed a doubling of our investment in two years. Our investment thesis played out faster than our original underwriting and we decided to harvest our gains at the end of January.

Starbucks has been a long-term holding for us. During the pandemic, Starbuck's management team, led by CEO Kevin Johnson, was thoughtful, data-driven, and focused on execution. Since closing most store locations, Starbucks has methodically – and in accordance with local regulations – reopened the vast majority of its locations. Moreover, the company quickly adjusted to new ways of serving such as mobile-order-and-pay, curbside pickup, and delivery. Starbucks has also opportunistic rationalized its footprint while adapting to more takeout/delivery orders with new store formats and drive-through's. With such a strong management team, it did not come as a surprise to us to learn that several of Starbucks' senior manager were recruited to lead other large public companies. Given that Starbucks was trading at approximately 40x current year earnings versus its 10-year average of 26x, we concluded that we could compound capital at a higher rate with our new ideas.

Visa is a leader in payments and an investment we have held over several different time periods given its exposure to the long-term secular trend of payments shifting from cash & check to debit & credit. As a processor of payments, transactions on Visa's network grew with personal income and the increasing share of purchases made with debt and credit at the point of sale. This is a powerful secular growth story that only became more compelling with the step change in digital payments stemming from the pandemic. However, Visa trades at a premium to its historical multiple, even adjusting for today's low interest rates. More importantly, as we think about where the payment industry is headed given the technological advances made in fintech, we have become increasingly concerned that Visa may be disintermediated in the future. While this risk seems low, it is not immaterial. With growing interest and adoption of digital currencies (crypto and central bank digital currencies) along with increased regulatory scrutiny over Visa's market power, we think Visa faces risks that are not just real but growing. We expect Visa's management to respond to these challenges head on, but any deterioration in Visa's premium multiple would mute returns. While we may be early with our concerns, these risks coupled with a full valuation and the attractiveness of our new investments, compelled us to harvest our gains and reallocate to new ideas with more favorable risk-reward.

Looking Forward

We see many opportunities and challenges in 2021. For instance, there are still over 10 million people unemployed or underemployed. However, as the rollout of several effective vaccines continues, we expect to see a big spike in consumer and business activity, and thus an environment that should provide more job openings. A steeper yield curve unsettled the market in recent weeks and will increase borrowing costs for individuals and businesses, but it is also a positive signal of economic expansion. With further stimulus packages planned in the U.S. and abroad, we believe that the U.S. is well positioned for a strong economic recovery. It has been our experience that, over time, stock price appreciation directly correlates with earnings growth. **With a strong economic backdrop, we believe our portfolio of high-quality growth stocks trading at reasonable valuations is well positioned to compound earnings and returns for the years to come.**

WITH A STRONG ECONOMIC BACKDROP, WE BELIEVE OUR PORTFOLIO OF HIGH-QUALITY GROWTH STOCKS TRADING AT REASONABLE VALUATIONS IS WELL POSITIONED TO COMPOUND EARNINGS AND RETURNS FOR THE YEARS TO COME.

We have made significant strides since our management-led buyout in 2017 and are proud to introduce our new firm name this quarter. As **TCM – TRAN CAPITAL MANAGEMENT**, we look to continue to build a lasting partnership with you, all while seeking to generate outstanding investment returns. Thank you for your partnership and we look forward to our next correspondence. If you have any questions, please contact us at (415) 461-3800.

Sincerely,

Quoc K. Tran
Chairman & CIO

Eric A. Winterhalter
President

Important Disclosures

**The information contained in the 'Fiscal Year Returns' and 'TCM Multi Cap vs PSN ALL Cap Core' charts are based on the Non-Taxable Multi-Cap Growth Equity composite and were produced using Created with Zephyr StyleADVISOR. Manager returns were supplied by: Informa Investment Solutions, Inc.(PSN) The S&P 500® Index and PSN All Cap Core Universe are not available for direct investment. Past performance is not indicative of future results. The actual return and value of an account will fluctuate and at any point in time could be worth more or less than the amount initially invested.*

Performance is provided as supplemental information and is based on the Non-Taxable Multi-Cap Growth Equity Composite. Performance results reflect all income, gains and losses and the reinvestment of interest and other income. All rates of return are reported "NET" of fees. Additional information regarding the policies for calculating and reporting returns is available upon request. A complete listing and description of all TCM composites and performance results is available upon request.

The 1-year, 3-year, 5-year and 10-year net of fees returns of the Non-Taxable Multi-Cap Growth Equity Composite as of March 31, 2021 are 62.62, 18.16, 14.52 and 12.15 respectively. The 1-year, 3-year, 5-year and 10-year returns of the S&P 500® Index as of March 31, 2021 are 56.35, 16.77, 16.30 and 13.91 respectively. 3-year, 5-year and 10-year performance figures are annualized.

The S&P 500® is an unmanaged stock market index and is not available for direct investment. The S&P 500® Index represents the stocks of 500 leading U.S. publicly-traded companies from a broad range of industries. The performance of an unmanaged index reflects no deductions for fees, expenses or taxes which would affect performance of actively managed assets. The volatility of the S&P 500® Index may be greater or less than the volatility of the portfolios in the composite.

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