TRAN CAPITAL MANAGEMENT

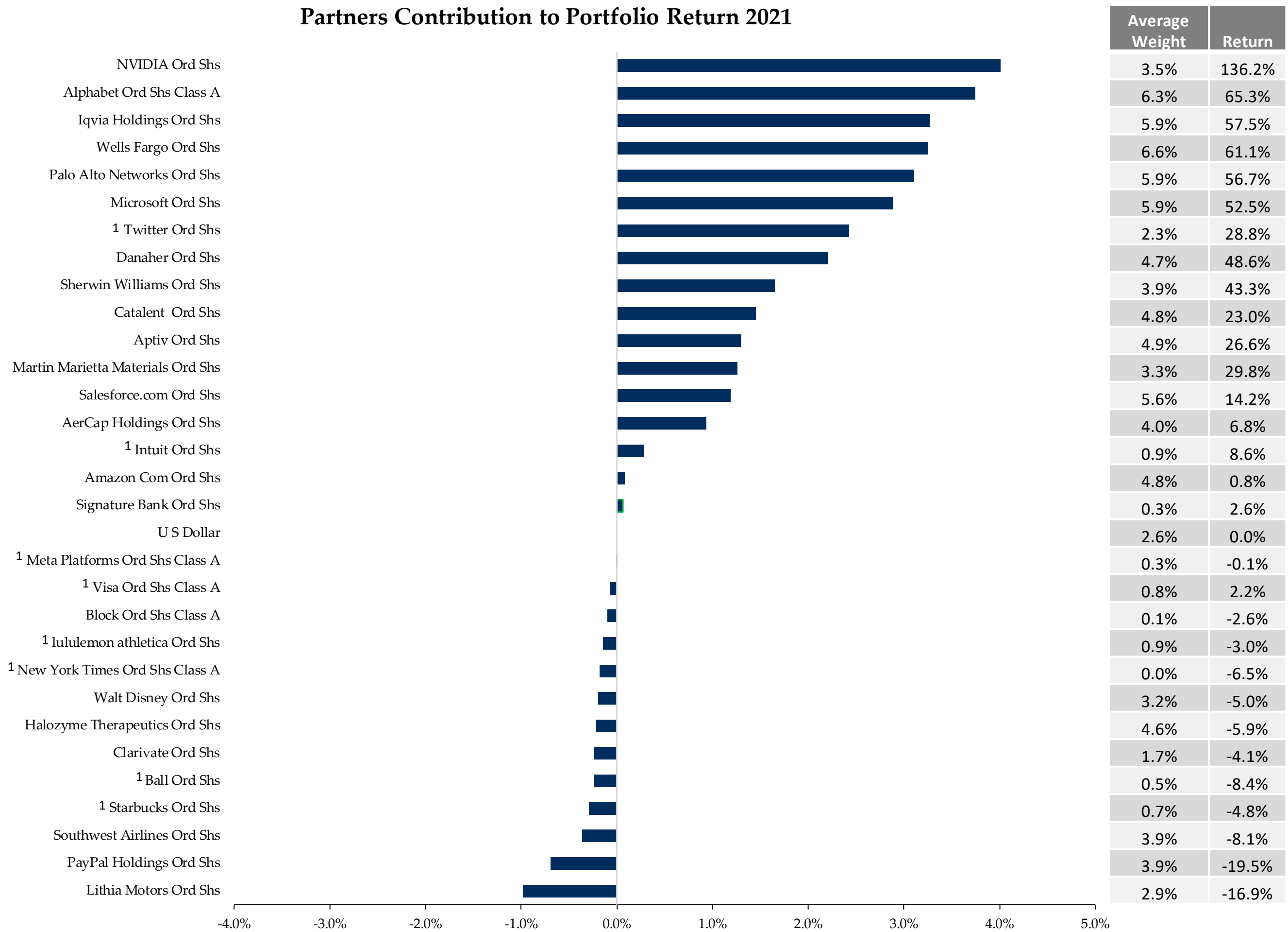
Partners Strategy | Fourth Quarter 2021

Dear Clients,

We wish you a Happy New Year and hope that 2022 will be a year of good health, prosperity, and continued growth. Despite the many challenges in 2021, our Partners strategy returned 27.5%, net of fees, vs. the S&P 500's return of 28.7%. This brings our trailing 3- year return to 33.8% net of fees vs. the market's return of 26.1%. These are strong absolute and relative returns and we do not take these results lightly or for granted. As many of our clients know, the average return for U.S. equities over the long-term is about 6-8% per year. In this letter, we'll highlight positive and negative contributors to our 2021 performance, share our thoughts of pertinent economic factors, and describe how we've positioned the portfolio for continued growth. While we continuously monitor and consider various macro risks, including inflation, Federal Reserve policy, and other geopolitical concerns, it is important to remember that we invest in companies that have competitive advantages that are strengthening, intrinsic values that are growing, and valuations that are reasonable. To us, the shift in the Fed's tone towards more hawkish policies and the pull forward of rate hike expectations represent the Fed taking their *foot off the gas* rather than *stepping on the brakes*. As such, we continue to believe that quality earnings growth will drive stock prices.

The next page shows our attribution table for the prior year. Among our top contributors to performance were **NVIDIA Corporation (NVDA)** and **Alphabet (GOOGL)**. **NVIDIA** is a leading semiconductor company whose pioneering parallel processing chip architecture integrated with software applications has enabled the company to leapfrog the competition and become the market leader for complex and data intensive applications. These end markets include growing industries like artificial intelligence, autonomous vehicles, and augmented & virtual reality driving the metaverse. We researched NVIDIA in the past but felt that the company's valuation properly reflected its growth prospects. But in March 2021, a selloff in technology companies brought NVIDIA down with it, creating a great entry point. Despite the strong stock price returns thus far, our confidence in NVIDIA's growth prospects is stronger now than at the time of our underwriting as end market demand has only continue to growth all while NVDIA strengthens its ecosystem of offerings that bring hardware and software together.

Alphabet has been in our portfolio since 2015. Alphabet was a strong performer in 2020 as its cloud-based services and Google Cloud Platform benefited from the need for digital transformation highlighted by the pandemic. Meanwhile, throughout the past 2 years, YouTube grew advertising revenues at a strong pace as its audience expanded from consumer viewing habits shifting away from linear television and as advertisers sought effective ways to reach unique audiences. While the Search advertising declined at the onset of the pandemic, these advertising revenues have rebounded and grown sharply with the reopening of the country, especially in the areas of media, finance, and travel. Further, as other advertising platforms faced hiccups with the implementation of Apple's App Tracking Transparency which wiped out Identifiers for Advertisers (IDFA) used to track users across applications and the web, Alphabet's Search ads were unaffected since search performed through keywords and intent, translating to lower impact on returns on advertisements and thus strong demand as ad buyers advertised to make up lost revenues from the pandemic. We believe that Alphabet is a good example of many of our portfolio companies' competitive strengths paying off during periods of disruption.



	Average Weight	Return
NVIDIA Ord Shs	3.5%	136.2%
Alphabet Ord Shs Class A	6.3%	65.3%
Iqvia Holdings Ord Shs	5.9%	57.5%
Wells Fargo Ord Shs	6.6%	61.1%
Palo Alto Networks Ord Shs	5.9%	56.7%
Microsoft Ord Shs	5.9%	52.5%
[1] Twitter Ord Shs	2.3%	28.8%
Danaher Ord Shs	4.7%	48.6%
Sherwin Williams Ord Shs	3.9%	43.3%
Catalent Ord Shs	4.8%	23.0%
Aptiv Ord Shs	4.9%	26.6%
Martin Marietta Materials Ord Shs	3.3%	29.8%
Salesforce.com Ord Shs	5.6%	14.2%
AerCap Holdings Ord Shs	4.0%	6.8%
[1] Intuit Ord Shs	0.9%	8.6%
Amazon Com Ord Shs	4.8%	0.8%
Signature Bank Ord Shs	0.3%	2.6%
U S Dollar	2.6%	0.0%
[1] Meta Platforms Ord Shs Class A	0.3%	-0.1%
[1] Visa Ord Shs Class A	0.8%	2.2%
Block Ord Shs Class A	0.1%	-2.6%
[1] lululemon athletica Ord Shs	0.9%	-3.0%
[1] New York Times Ord Shs Class A	0.0%	-6.5%
Walt Disney Ord Shs	3.2%	-5.0%
Halozyme Therapeutics Ord Shs	4.6%	-5.9%
Clarivate Ord Shs	1.7%	-4.1%
[1] Ball Ord Shs	0.5%	-8.4%
[1] Starbucks Ord Shs	0.7%	-4.8%
Southwest Airlines Ord Shs	3.9%	-8.1%
PayPal Holdings Ord Shs	3.9%	-19.5%
Lithia Motors Ord Shs	2.9%	-16.9%

[1] We no longer hold Twitter, Intuit, Meta Platforms, Visa, Lululemon, New York Times, Ball and Starbucks.

**See Footnote Disclosure on "Important Disclosures" page.*

The main laggards in our portfolio were **Lithia Motors (LAD)** and **PayPal (PYPL)**. **Lithia Motors** is a leading automotive dealer that is quickly growing its e-commerce capabilities for new and used autos. The auto industry is dealing with various supply chain and semiconductor shortages, which have impacted the availability of new vehicles. While this has resulted in higher-than-normal margins for both new and used autos sold at Lithia's dealerships, the decline in vehicle inventories has led to a broader selloff in the dealership market. We believe that this masks the underlying strong performance at Lithia and the company's continued playbook of acquiring underperforming dealerships and investing in omnichannel capabilities. We believe that in a normalized environment, Lithia can achieve and potentially outperform its targeted $50 in EPS by 2025. With Lithia's stock trading at $300 per share, we find the opportunity compelling.

PayPal is a leading FinTech company that is disrupting traditional payment methods and leading the shift to e-commerce and peer-to-peer payments. PayPal sold off during the fourth quarter on concerns of a potential acquisition of Pinterest (PINS), a weaker than expected sales outlook, and a general technology sector sell off. Although the acquisition of Pinterest raises questions on the combined synergies, we think the stock price decline was overdone on the capital allocation concern. Our thesis on PayPal has not changed.

Why Rising Interest Rates Matter

When we invest in stocks, we are purchasing a security where the share price reflects a stream of future earnings or cash flows discounted back to today. Assuming no change in underlying growth, higher stock prices are achieved through investor willingness to pay larger multiples or – in other words – investor willingness to discount future earnings at a lower rate, making them worth more today. As such, during a low and/or declining interest rate environment, investors are willing to pay more for high growth companies. However, as interest rate expectations flip (as they are today), higher interest rates mean future earnings are discounted back at a higher rate, reducing the present value of the stock and these high multiples. Absent an offset coming from higher-than-expected growth, multiple contraction begets lower stock prices.

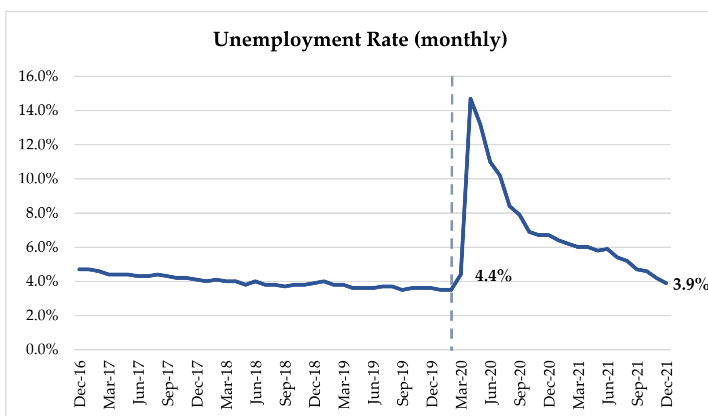
Over the past several decades, interest rates have steadily declined. As we enter 2022, it appears that economic factors like unemployment, inflation, and growth have met the conditions to warrant the Federal Reserve to increase interest rates. **We believe this is a significant inflection point** but view the Fed's expected rate increases as well telegraphed and more akin to *taking their foot off the gas* rather than *slamming on the economic brakes*. As of now, the expectations are for three rate hikes in each of 2022 and 2023.

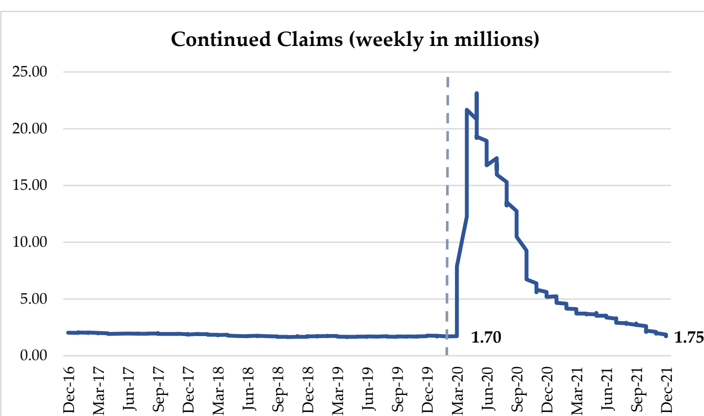
In such an environment, we believe the following:

- Expensive multiple companies generating little-to-no cash flow will experience more severe multiple contraction
- Individual company earnings growth needs to be robust enough to offset multiple contraction
- Certain sectors like financials can and will likely benefit from higher interest rates
- Stock selection is critical to constructing a portfolio of growing companies that trade at reasonable valuations

Portfolio Positioning

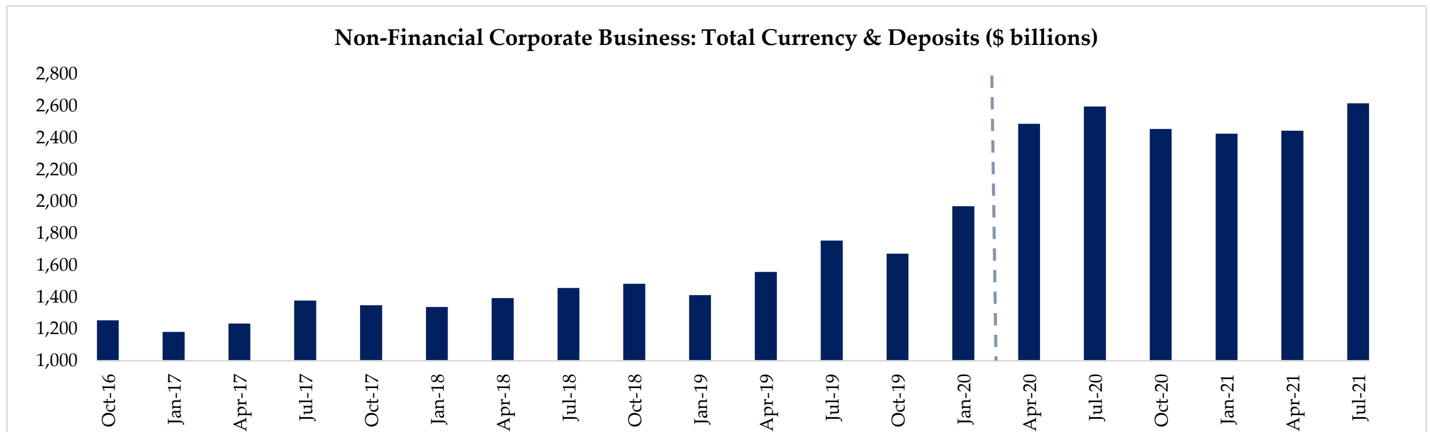
As we enter 2022, we observe that economic conditions are strong. The U.S. GDP is likely to have grown 6% in 4Q 2021 and is estimated to grow ~4% in 2022. **Over the past two years, U.S. households have accumulated over $2.5 trillion dollars in excess savings** due to government stimulus, decreased spending and travel as households focused on getting through waves of covid infections.[1] More recently, the U.S. unemployment rate and continuing unemployment claims have both improved to pre-pandemic levels. Since approximately two-thirds of U.S. GDP is driven by consumer spending, we view the improvement in jobs and decrease in continuing unemployment claims as positive indicators of economic growth.





Source: Federal Reserve Bank of St. Louis

[1] Pantheon Macroeconomics, U.S. Economic Monitor, January 11, 2022



Source: Federal Reserve Bank of St. Louis

Furthermore, corporate profitability and balance sheets are at record levels, creating a favorable backdrop for continued corporate profit growth. As the Federal Reserve raises rates and consumer and corporate spending increase, inflation may be more persistent. Therefore, we have positioned the portfolio in the following categories:

Rising Rate Beneficiaries

While the core theses for our investments are based on the ability to execute growth plans, we also evaluate whether our portfolio companies face headwinds or tailwinds from various macro factors. Rising interest rates is a significant factor that we are actively considering in our investments. We believe that several of our portfolio companies will benefit in a rising interest rate environment. These include, **Wells Fargo (WFC), Signature Bank (SBNY), and AerCap (AER)**.

Healthcare Services

We believe our healthcare services companies will see continued growth and perhaps a sustained step-up in demand for their services due to recent events. Specifically, **Catalent (CTLT), Danaher (DHR), and IQVIA (IQV)** benefit from the manufacturing of vaccines, demand for COVID and flu testing, and the need for clinical trials to support the rollout of vaccines and therapies. These factors were not part of our original underwriting of these investments and have strengthen our assessment of their growth prospects. Additionally, growing biopharma funding, R&D pipelines, and backlog should provide many years of strong demand for these healthcare companies.

Digital Transformation

We have several technology investments that provide services and solutions that enable businesses to safely embrace digital transformation, whether through day-to-day processes or full IT stacks. These include **Microsoft (MSFT), Alphabet (GOOGL), Amazon (AMZN), Palo Alto Networks (PANW), Salesforce.com (CRM), and NVIDIA (NVDA)**. While many of these companies have appreciated, we still believe they have many years of robust growth ahead.

Electric Vehicles

Disruption is complex and can take time before being realized. For instance, the first electric automobile was developed in 1890-91 by William Morrison of Des Moines, Iowa. Today, plug-in hybrid and battery electric vehicles make up about 8% of global new car sales and is projected to account for roughly 1/3 by 2030.[2] We've owned **Aptiv (APTV)** since 2015, which has seen sustained above-industry

[2] Evercore ISI, Autos 2022 Outlook, January 4, 2022

growth rates due to its position as a leading provider of equipment and components that enable electric vehicles and active safety/autonomous driving. Despite APTV's strong stock performance, we think it is still in the early innings of growth.

Re-Opening Beneficiaries

Over the past year and a half, we've added investments that we believe will benefit as the country reopens. These include, **Disney (DIS), Southwest Airlines (LUV), AerCap (AER), and Block (SQ)**. All these companies have attractive long-term growth prospects, but we also feel that they are particularly well positioned in a re-opening environment.

Looking Forward

While the U.S. equity markets had a volatile start to 2022, we believe that the U.S. economic backdrop, corporate profitability, and state of the U.S. consumer remain healthy and improving. **With such a set up, we believe that our portfolio of growing companies that provide essential services will continue to generate robust revenue, earnings, and cash flow growth**. While we don't know what the market will do in the short term, we are confident that our portfolio of companies will continue to grow their intrinsic value over time. Thank you for your support and interest in TCM. We are delighted to be stewards of your capital.

Sincerely,

Quoc K. Tran
Chairman & CIO

Michael Im
Co-Portfolio Manager & Director of Research

Eric A. Winterhalter
President

Important Disclosures

**The Partners Contribution to Portfolio Return 2021 chart is as of the 1-year period ending 12/31/2021 and is for the Partners Strategy Representative Account, an actual account in the TCM Partners Strategy Composite. The contribution data is gross of fees and was produced using Refinitiv Eikon, an external performance attribution application.*

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 Partners Strategy 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 and 3-year net of fees returns of the Partners Strategy Composite as of December 31, 2021 are 27.52 and 33.82 respectively. The 1-year and 3-year returns of the S&P 500® Index as of December 31, 2021 are 28.72 and 26.07 respectively. 3-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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