TRAN CAPITAL MANAGEMENT

Multi-Cap Growth | Third Quarter 2023

Dear Clients and Friends,

We hope you and your family are well and enjoyed the summer. We are saddened by the events that have unfolded in Israel and our thoughts are with anyone that may have friends or family impacted by the attacks. This is yet another reminder that risks are always just under the surface and can be revealed at any moment. From geopolitical tensions to federal budget talks and union walkouts to risk that rates will stay higher for longer, there were certainly a lot of concerning headlines throughout the summer and fall. As always, we monitor these events and assess how they may affect our portfolio companies. While there are always concerns in the market, it is important to remember that we don't own the entire market. Rather, we own a collection of high-quality companies that we believe can grow faster than the overall market, are managed by experienced executives, and are reasonably priced.

Historically, the months of August and September are seasonally weak for the stock market. This year was no different. The S&P 500 Index was down -6.6% over the past two months. While frustrating, it is important to remember that this was the first negative quarter in a year and that a mid-single digit pullback is normal. Headwinds from a potential U.S. Government shut down, resumption of student loan payments, rising energy prices, and strikes from the UAW, WGA, and now Kaiser Permanente's staff contributed to the summer drawdown. While this can be uncomfortable, we believe the recent market setback may be a good set up for a positive fourth quarter and longer-term stock appreciation.

Further, not all factors are negative. Inflation continues its downward glidepath, the Federal Reserve's rate tightening cycle may be close to the end, capital markets are showing green shoots with some successful IPOs and debt offerings, and – most importantly – our portfolio's revenue and profit growth continue to be robust. While every cycle is different, we do note that just as August and September have been seasonally weaker months, October and November have been seasonally stronger. The table below shows the seasonality of S&P 500 returns by month since 2013. History never repeats itself, but it does often rhyme.

S&P 500 Seasonal Returns Heat Map

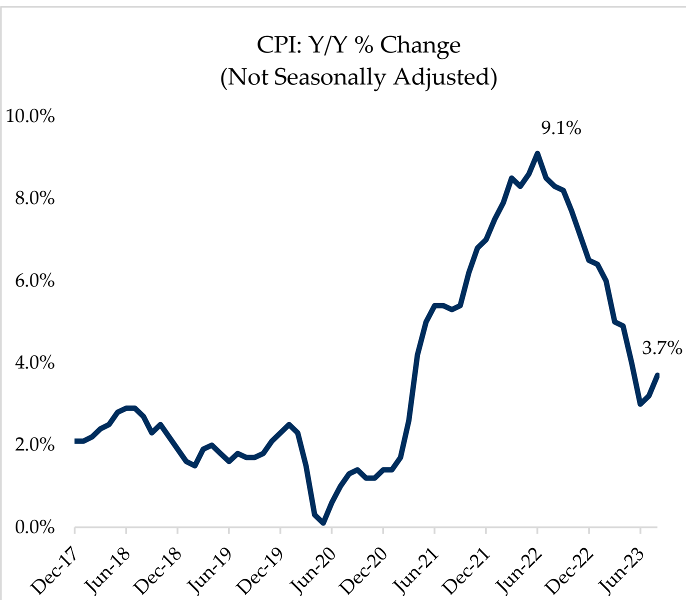
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
5 Year Avg	1.39	-1.97	-1.12	2.67	0.13	0.61	4.36	1.38	-3.17	1.45	4.10	-0.83
2023	6.18	-2.61	3.51	1.46	0.25	6.47	3.11	-1.77	-4.87			
2022	-5.26	-3.14	3.58	-8.80	0.01	-8.39	9.11	-4.24	-9.34	7.99	5.38	-5.90
2021	-1.11	2.61	4.24	5.24	0.55	2.22	2.27	2.90	-4.76	6.91	-0.83	4.36
2020	-0.16	-8.41	-12.51	12.68	4.53	1.84	5.51	7.01	-3.92	-2.77	10.75	3.71
2019	7.87	2.97	1.79	3.93	-6.58	6.89	1.31	-1.81	1.72	2.04	3.40	2.86
2018	5.62	-3.89	-2.69	0.27	2.16	0.48	3.60	3.03	0.43	-6.94	1.79	-9.18
2017	1.79	3.72	-0.04	0.91	1.16	0.48	1.93	0.05	1.93	2.22	2.81	0.98
2016	-5.07	-0.41	6.60	0.27	1.53	0.49	3.56	-0.12	-0.12	-1.94	3.42	1.82
2015	-3.10	5.49	-1.74	0.85	1.05	-2.10	1.97	-6.26	-2.64	8.30	0.05	-1.75
2014	-3.56	4.31	0.69	0.62	2.10	1.91	-1.51	3.77	-1.55	2.32	2.45	-0.42
2013	5.04	1.11	3.60	1.81	2.08	-1.50	4.95	-3.13	2.97	4.46	2.80	2.36

Source: Bloomberg

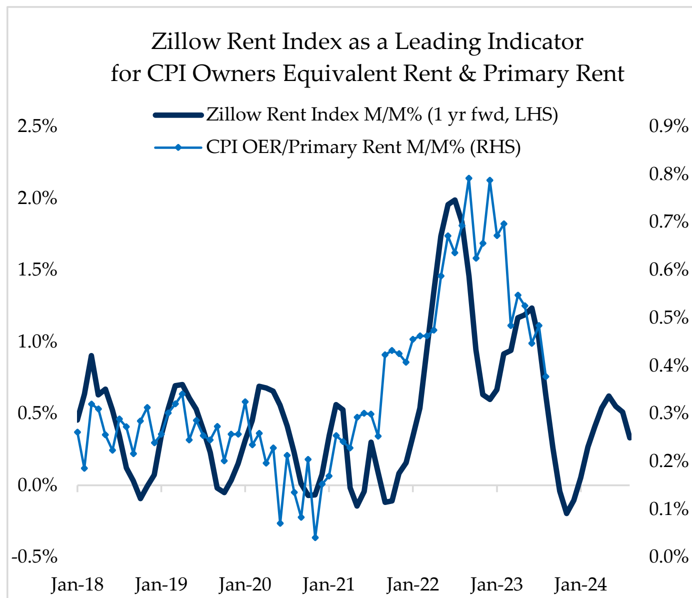
During the third quarter, the S&P 500 declined -3.3% while our Multi-Cap Growth Strategy declined -4.4%, net of fees. Year to date, our portfolio has returned 12.4% net of fees compared to the S&P 500's return of 13.1% and the equal-weighted S&P 500's return of 1.8%. With an 85% active share, or percent of our portfolio that is different in names and weights than the market, it is interesting that our performance has tracked close to the market. We believe that over time, earnings growth and superior returns on invested capital will drive stock price appreciation. **Based on consensus estimates, our portfolio is expected to grow earnings by 20% in 2024 compared to the market's expected earnings growth of 10%. Despite roughly 2x the growth, our portfolio is selling at 19x P/E, a slight premium to the market's multiple of 17x.** We believe these portfolio characteristics position us well as we enter the fourth quarter and prepare for 2024.

Glidepath Down for Inflation

In prior letters, we discussed the many causes of inflation and why we think inflation is decelerating. The Consumer Price Index (CPI) peaked in June 2022 at +9.1% y/y and has declined to +3.7% y/y in August 2023 (bottom, left). As regular readers know, we've discussed how shelter, made up of Owners' Equivalent Rent (OER) and Rent of Primary Residence, is the largest component of CPI at nearly 35% weight. We believe that many factors, including higher interest rates and slowing wage growth, will continue to bring OER down, and because OER is reported on a lag, we believe that future CPI reports will soon reflect this decline in OER. **As shown below, the m/m change in the Zillow Observed Rent Index leads the m/m change in CPI for OER & Rent of Primary Residence by about 1 year (bottom, right). If this relationship holds true, we should see a continued deceleration, and maybe even a decline, in the cost of shelter heading into and through 2024.**



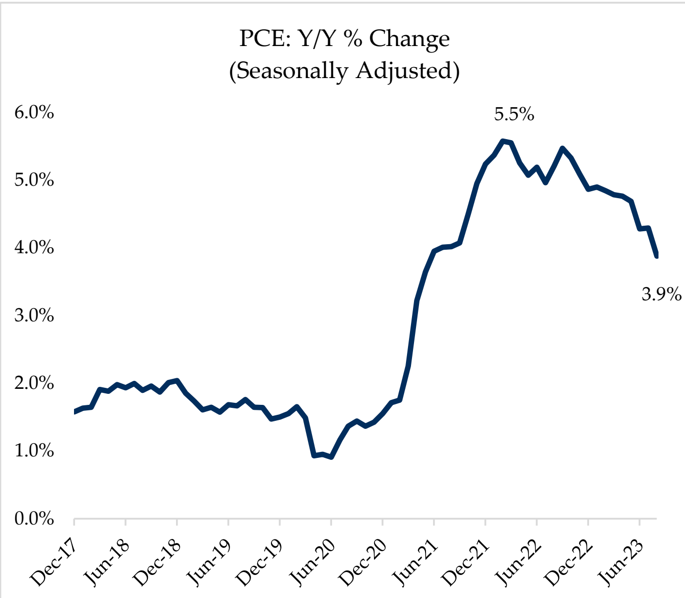
Source: Bloomberg



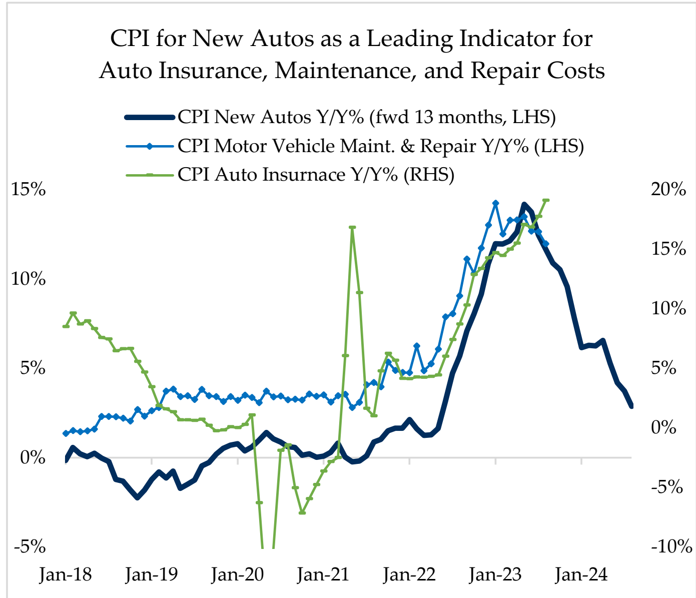
Source: Bloomberg and Pantheon Macroeconomics

In addition to the CPI, the Personal Consumption Expenditure (PCE) is an important inflation metric that the Fed also closely monitors. PCE tracks overall price changes in goods and services purchased by consumers. This indicator has also been declining since 2022. PCE peaked in February 2022 at +5.6% y/y and has declined to +3.9% y/y in August 2023 (next page, left). Beyond shelter, autos are also an important cost for most families. Auto prices, both new and used, spiked due to supply chain shortages during the pandemic. **As shown on the next page, the CPI for new autos has peaked and has been decelerating since April of last year. Moreover, the y/y change in new auto prices tends to lead auto insurance and maintenance & repair costs by ~13 months, suggesting those related components of CPI may have peaked as well.**

These datapoints support our view that the CPI is on a glidepath down. And as CPI fades, this eliminates a key force driving rate increases. We believe that once the Fed ends this tightening cycle, fundamental factors will have a bigger influence on stock prices, which will benefit our portfolio.



Source: Bloomberg



Source: Bloomberg and Pantheon Macroeconomics

Portfolio Positioning

Among our top contributors in the third quarter were **Baker Hughes (BKR)** returning +12.4% in the quarter, **Intuit (INTU)** +11.7%, **Alphabet (GOOGL)** +9.3%, and **Progressive (PGR)** +5.3%.

Baker Hughes is a leading energy technology company. Baker's services help clients extract resources efficiently and responsibly. Additionally, Baker is a leader in natural gas compression technology, which enables U.S. natural gas producers to increase their liquified natural gas (LNG) production. LNG allows for natural gas to be shipped as opposed to piped in the gas form. This has been instrumental in helping Europe avoid an energy crisis as they switch off from Russian oil and gas in response to Russia's war on Ukraine. **Longer term, LNG will be critical as a source of transitional energy as the world shifts towards solar, wind, and other renewables.**

We mentioned **Intuit** in our second quarter letter as a potential beneficiary of generative AI. Through QuickBooks, TurboTax, Credit Karma, and Mailchimp, Intuit has access to differentiated data that can be mined and used to develop AI-assisted features. We posited that such features could expand Intuit's product offerings and enhance its moat with consumers and small businesses. In early June, Intuit announced its push into generative AI with the release of its proprietary financial large language model and operating system that will leverage its data to create new AI-assisted solutions and derive more AI-driven answers for customers. Intuit's further expanded upon its differentiation and AI opportunity at its investor day in September. **With over 60,000 datapoints per consumer and 500,000 datapoints per small business, Intuit is in prime position to leverage AI to further enhance its moat and drive growth.**

Alphabet's stock price grew 9.3% during the third quarter and is up 48.3% year-to-date. As we've written in prior letters, Google and YouTube continue to enjoy robust growth. In addition, the spark from generative AI is fueling increasing demand for Google's cloud business. Training large language models used for generative AI is computationally intense, and we believe Google's cloud computing infrastructure (along with Microsoft Azure and Amazon Web Services) will see a step-change in demand for years to come. Despite the recent stock price appreciation, Alphabet still trades at a reasonable P/E multiple of 20x 2024 earnings. **We appear to be on the cusp of**

the next wave of technological growth with generative AI. In a few years, we may look back and see this point as akin to the beginning of the internet age.

Progressive is a leading auto and home insurance company. We believe Progressive is one of the best managed companies in the insurance space and in our portfolio. However, the company (and stock price) can go through periods of volatile earnings. On July 13th, Progressive reported disappointing underwriting results for the month of June caused by high costs for vehicle repair and bodily injury. These elevated severity trends meant larger than expected underwriting losses on the insurer's current auto policies as well as policies written in prior years, leading to the need for charges to build additional reserves. Further, the homeowners' segment was hit by hurricanes in Florida. The stock dropped over 13% on this earnings report. We evaluated PGR's results, its actions to improve profitability, and trends in vehicle repair costs (mentioned earlier) and concluded that it was a short-term issue that does not change our long-term thesis. PGR stock subsequently recovered and rallied nearly 20% from $115 on July 14th to nearly $140 at quarter end. **This is an important reminder to not let short-term concerns shake us out of quality investments.**

Market returns have been narrow with the largest companies contributing most of the year-to-date gains. In fact, the equal-weight S&P has only returned 1.8% for the year. We believe that there are several companies in our portfolio that trade at stock prices that do not reflect our assessment of their intrinsic value. Among the detractors in the third quarter were **Entegris (ENTG)** returning -15.2%, **Ball Corp (Ball)** -14.2%, **IQVIA (IQV)** -12.5%, and **Martin Marietta Materials (MLM)** -11.1% in the third quarter.

We discussed **Entegris** in our last letter as it was one of our top contributors in the second quarter and through the first half, returning +69.4% through the first 6 months of 2023. Entegris supplies the semiconductor industry with specialty chemicals and materials, micro-contamination filters, advanced planarization solutions, and advanced materials handling solutions that ensure purity and reduce defects during the semiconductor manufacturing process. These critical solutions enable the transition to leading-edge nodes, which today have thousands of layers and require 4-5x more materials content per wafer. We attribute the pullback in the quarter to profit taking across semi names after a strong first half sparked by generative AI. We believe that Entegris' position as a leading *picks and shovels* provider to the semiconductor industry along with continued demand for more advanced, accelerated computing chips (that was only heightened by generative AI) will allow Entegris to grow at above market rates for the foreseeable future.

Ball Corp is a leading aluminum packaging manufacturer. The stock has performed poorly due to weak demand trends fueled by a lack of retail promotions and soft mass beer sales, in which Ball is over-indexed. We believe these developments are temporary and that, over time, demand will grow for aluminum cans. During the quarter, Ball also announced the sale of its (non-core) aerospace division to BAE Systems for $5.6 billion at a 20x LTM EV/EBITDA valuation. We applaud this strategic decision as the aerospace division is more capital intensive and has lower profit margins than Ball's beverage packaging business, yet the aerospace division was sold at a higher multiple than Ball as a whole. Ball's market capitalization is ~$15.5 billion. We expect the sale to close in the first half of 2024 and for Ball to use the proceeds to pay down debt and repurchase shares, returning Ball to a balanced capital allocation strategy after multiple years of growth capex. With the stock selling at 15x 2024 P/E, we believe Ball has compelling upside as management is taking appropriate steps to unlock value.

IQVIA is a leading provider of outsourced clinical trials and technology solutions to the pharma and biotech industry. Healthcare and life science stocks have lagged the broader market due to concerns over lower funding for research and development. While R&D spending may slow in the short term, our research suggests that over time, pharma and biotech R&D spending grows in the mid-single digits. IQVIA's services help lower costs, measure effectiveness, and commercialize life-saving drugs. We believe IQVIA provides critical services and has a durable and robust backlog of contracts.

Martin Marietta Materials is a leading aggregates company whose stock price appreciated 37% in the first half of 2023. In the third quarter, Martin Marietta's stock price declined 11%. We think this pullback was probably driven by some profit taking. Our checks with Martin Marietta reaffirm our view that the company has a long runway of growth and maintains strong pricing power.

Looking Forward

As we enter the fourth quarter, we are monitoring for potentially disruptive events, but we are comforted by the core products and services offered by our portfolio companies and their long-term demand trajectories. With leading market positions in growing markets along with experienced management teams at the helm, many of whom have successfully navigated turbulent times in the past, we believe our holdings will emerge stronger as time unfolds. Thank you for your partnership with us and if you have any questions, please contact us at (415) 461-3800.

Sincerely,

Quoc K. Tran
Chairman & CIO

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President

Important Disclosure

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 September 30, 2023, are 15.90, 2.77, 5.64 and 7.54 respectively. The 1-year, 3-year, 5-year and 10-year returns of the S&P 500® Index as of September 30, 2023, are 21.61, 10.17, 9.93 and 11.92 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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Select assets shown; additional Non-Taxable Multi-Cap Growth Equity investment information is available including the complete portfolio upon request.

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