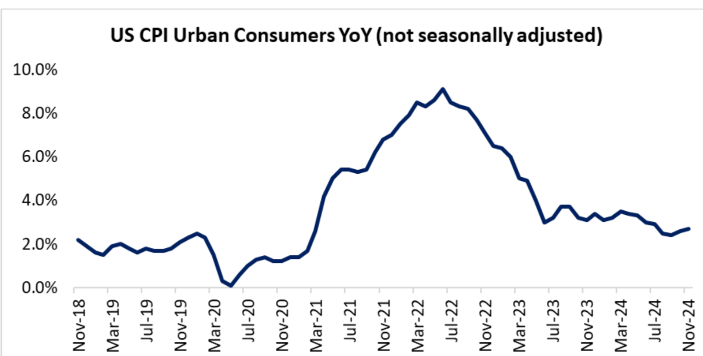
TRAN CAPITAL MANAGEMENT

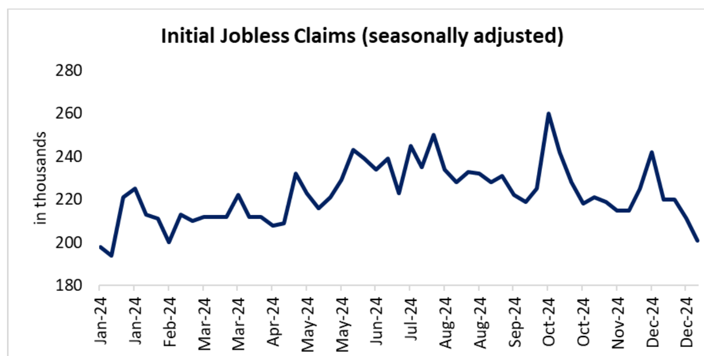
Multi-Cap Growth | Fourth Quarter 2024

Dear Clients and Friends,

Happy New Year to all our clients and friends. We want to start by thanking you for entrusting your assets to us. We love our work and couldn't do it without you. As we write this, many of our clients, friends, and family living in Southern California are experiencing devastating wildfires. Our thoughts are with you all during this difficult time.

In 2024, the U.S. economy benefited from declining inflation, healthy employment levels, and a steady GDP growth. Inflation, as measured by the Consumer Price Index (CPI), peaked in June 2022 at 9.1% and declined to 2.7% in November. While factors like housing affordability and automobile costs remain elevated, the trend is heading in the right direction. Additionally, the U.S. employment picture continues to be healthy, with initial jobless claims remaining relatively low throughout the year. As of the most recent report in January, initial jobless claims were 201K and unemployment remains around 4%. Meanwhile, real GDP growth was 2.7% as of September 2024.





Source: Bureau of Labor Statistics and Department of Labor via Bloomberg

With these economic conditions, the Federal Reserve cut the upper bound of the Federal Funds Rate from 5.5% to 4.5% from September to December. The U.S. stock market generated another positive year in 2024 with the S&P 500 returning 25.0%. Our Multi-Cap Growth Strategy returned 17.3%, net of fees, in 2024. By comparison, various slices of the market returned the following.

Index	Total Return (YTD)
S&P 500 (SPX)	25.00%
S&P 500 Equal Weighted (SPW)	12.98%
S&P Midcap 400 (MID)	13.89%
Russell 2000 (RTY)	11.53%

Last year's stock market performance was once again dominated by the largest tech companies. **The Magnificent Seven (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla) on average returned over 60% and accounted for over half of the S&P 500's 2024 return.** While we own some of the seven, we do not own all of them. Specifically, we do not own Apple and Tesla due to our fundamental concern that they are particularly expensive relative to their earnings growth. The overall market is selling at about 21x forward earnings estimates and earnings are expected to grow about 8-10% in 2025. By contrast, Apple is selling at 33x forward earnings and expected to grow earnings 9% this year. Tesla, meanwhile, is selling at 122x forward earnings and is expected to grow earnings 34% this year after an estimated -22% decline in earnings in 2024.

While both companies are leaders in their spaces and have been remarkably successful, we think that their prospects will not be as robust as their past, leading us to look for more attractive opportunities in other areas of the market. **In fact, the S&P 500 Equal Weighted Index and the S&P Mid-Cap Index both returned about 13% in 2024. Many of these companies are less expensive than Apple and Tesla and enjoy above average earnings growth. Similarly, our portfolio has historically been smaller and grows earnings faster than the S&P 500.** Approximately half of our portfolio's market cap in between $2 billion and $100 billion. We've noticed that in recent years, the largest company's valuations have expanded faster than the rest of the market. We don't know if this trend will continue, especially with their current high valuations. Rather, we focused on our companies' ability to grow and believe that stock prices will follow revenue and earnings growth over the long term.

Portfolio Positioning

We aim to build portfolios of growing companies that are reasonably valued. Our belief is that our companies provide essential services to their customers, offering a significant opportunity to increase shareholder value over time. In 2024, we experienced robust stock price appreciation in several of our investments. However, some investments, despite strong fundamental growth, have not yet seen their stock prices reflect our appraisal of their intrinsic value. We believe this discrepancy presents opportunities for future gains.

One of the themes we are heavily invested in is the growth of artificial intelligence and the infrastructure needed to support large language models. Our core positions include NVIDIA, the leading semiconductor design company; Taiwan Semiconductor Manufacturing, the leading outsourced manufacturer of semiconductors; and major players in software, cloud computing, and AI models such as Microsoft, Meta Platforms, Alphabet, and Amazon. As we studied this AI wave, we learned that the power needed to support it is tremendous. For instance, a ChatGPT prompt requires 10 times more power than a traditional web search query. The Electric Power Research Institute estimates that data center consumption of total U.S. electricity could more than double from 4% in 2023 to 9% in 2030.

To address this, we added **Talen Energy (TLN)**, a leading independent power producer, to our portfolio last year. Talen was one of our top performers, appreciating from our initial cost of $115 to over $200 by year end. Despite this rapid appreciation, we believe the current price still does not reflect the company's true value. Even with this appreciation, Talen's market cap is only $9 billion, while we estimate the replacement cost for Talen's assets to be about $25 billion. Our research suggests that Talen has an opportunity to supplement their long-term energy contract with Amazon Web Services with another leading technology company. Additionally, Talen has done an excellent job returning excess capital to shareholders by buying back over 24% of their shares outstanding in 2024. We applaud this capital allocation decision, especially when the stock is selling below our appraisal of Talen's intrinsic value. We believe there is more to come and suspect Talen's stock price will appreciate as their fundamental metrics continue to grow.

As technology gets more complicated, software is essential to transforming business processes and creating new applications. Software engineers need tools to help them organize, test, and fix their software code. GitLab (GTLB) provides essential DevSecOps tools to help software engineers work more efficiently. GitLab offers a free version of their software and as users find it useful, they often upgrade to higher paying tiers. In fact, one of Gitlab's key metrics tracks how much current customers increase their subscriptions. GitLab's 2024 revenues grew by over 30%, with more than 9,000 customers paying over $5,000 a year, contributing to 95% of the company's annual recurring revenue. The market remains highly underpenetrated with 95% of the market not standardized on a software tool platform such as GitLab. Moreover, GitLab maintains a very healthy 90% gross margin, and its operating profit margins are inflecting as GitLab continues to scale. The company's EBITDA margins are expected to improve from -28% in FY24 to positive +10% in FY25.

While GitLab's stock price declined in 2024, we believe that the company's long-term growth coupled with high incremental margins will lead to share price appreciation in the future. Though GitLab was a laggard in 2024, we believe it may be a leader in the future.

GitLab embodies many of the characteristics we seek in our investments: leading companies that provide essential services and have a long runway for growth. We also see these traits in a leading supplier to the housing industry. **For decades, the U.S. has faced a housing shortage, with the average age of existing homes over 40 years old and new construction not keeping up with demand. This complex issue will take time to address, but one solution is to make it easier to build more houses.**

Source: U.S. Census Bureau via Bloomberg

We believe that we may be at a cyclical low point in new home construction. We have invested in various companies in this sector and are excited to recently add **Builders FirstSource (BLDR)**. Builders FirstSource manufactures and distributes building products to professional homebuilders. While home construction methods haven't changed dramatically over the years, many builders still perform most work on-site, including framing, scheduling sub-contractors, cleaning up waste, and installing appliances and HVAC systems. Builders FirstSource has evolved from being a lumber provider to manufacturing and offering value-added products such as prefabricated truss systems, wall panels, windows, and pre-hung doors. These value-added products can reduce a home builder’s construction time by up to two weeks, increase safety, and reduce waste. It's not surprising that these value-added products now make up about half of Builders FirstSource’s sales while also earning higher margins than the commodity lumber segment.

Our research suggests that the building materials and supplies industry is highly fragmented with pro-dealers accounting for roughly 1/3 of the $385 billion market. Builders FirstSource’s 2024 revenue of $17 billion gives us confidence that there is ample opportunity for them as homebuilding grows and expands to more markets. We expect Builders FirstSource to grow EPS at a mid-teens rate over the next 3-5 years. Finally, we believe the company’s valuation is attractive at 13x next year’s estimated earnings per share.

Looking Forward

As we begin 2025, we are mindful of the many the tailwinds and headwinds facing the market. The U.S. economy remains robust with GDP projected to grow between 2-3%. While inflation may tick up depending on the severity of future tariffs, more favorable policies towards domestic energy production may increase supply and provide some deflationary counterbalance. Employment levels remain healthy, and fiscal and regulatory policies appear favorable for financial markets.

While we monitor these forces, our primary focus is spending time to research and select leading companies like Talen Energy, Gitlab, Builders FirstSource, and other companies that provide essential services, are led by smart management teams, and have significant growth potential.

Thank you for your support and interest. If you have any questions, please feel free to contact us at (415) 461-3800.

Sincerely,

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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 December 31, 2024, are 17.31, 0.52, 9.91 and 9.26 respectively. The 1-year, 3-year, 5-year and 10-year returns of the S&P 500® Index as of December 31, 2024, are 25.02, 8.94, 14.52 and 12.28 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.

Benchmarks and financial indices are shown for illustrative purposes only and are provided for the purpose of making general market data available as a point of reference only. Such benchmarks and financial indices are unmanaged, assume reinvestment of income, do not reflect the impact of any trading commissions and costs, management and incentive fees, and have limitations when used for comparison or other purposes because they, among other reasons, may have a different trading strategy, volatility, credit or other material characteristics (such as limitations on the number and types of securities or instruments). No representation is made that any benchmark or index is an appropriate measure of comparison.

Select assets shown; additional Non-Taxable Multi-Cap Growth Equity investment information is available including the complete portfolio upon request.

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