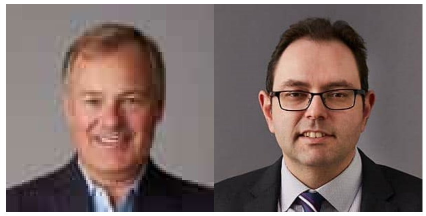
QUARTERLY COMMENTARIES

A HEALTHY ROTATION IN MARKET LEADERSHIP



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Quarterly Commentary – October 1, 2024

Investors in the stock and bond markets were well rewarded in the third quarter of 2024, provided they had the strength and resolve to hold the course through a difficult patch that began in the middle of July and lasted through the first week of August. In Q3, domestic stocks, as measured by the S&P 500, Dow Jones Industrial Average and NASDAQ Composite indexes, returned +5.9%, +8.7% and +2.8%, respectively, including dividends. Foreign equities rose as well, driven by similar economic forces across the developed world. The MSCI All-World (ex-USA) Index rose in Q3 by +8.2%. Bond holders were also rewarded, as falling interest rates translated into capital gains. The Bloomberg Aggregate Bond Index gained +5.2% in the quarter.

The aforementioned “difficult patch” saw the S&P 500 decline by -8.2%, and the NASDAQ Composite decline by -13.1% over a period of roughly three weeks. In our last quarterly letter, we noted that the economic backdrop supported the gains we experienced in the first half of 2024, with diminishing inflationary pressures, steady growth in economic output, and full employment. The broadening commercial deployment of artificial intelligence (“AI”) offered exciting opportunities for businesses to drive efficiencies and pursue new avenues for growth. We also shared our view that stock valuations were looking stretched, that the margin of safety in stocks had diminished, and that a sense of complacency had set in among many investors. While these are all worrying signs, they were not reason to reduce our exposure to the equity markets, but a reminder that we need to be vigilant and ready to act if necessary. We reminded ourselves that markets move in both directions, and we should brace ourselves for volatility simply because it’s the nature of markets to react to uncertainty in whatever form it takes.

The about-face in the markets was triggered in part when investors began to look at AI through a new lens, questioning whether massive investments in the technology would produce earnings commensurate with the requisite outlays. At the same time, weaker-than-expected jobs data led a growing number of economists and investors to believe that the economy may be sinking into recession. Then in August, an unexpected move by the Bank of Japan (that country’s central bank) to raise interest rates caused the Japanese Yen to strengthen. The strong Yen disrupted an arcane, but very popular institutional trade, driving investors to liquidate assets denominated in other currencies, in particular the US dollar, further fueling the drawdown in US equity markets. The damage was swift and widespread, but NASDAQ-traded “momentum stocks” were the hardest hit as investors (particularly hedge funds) reduced their exposure.

As mentioned in our letter to you last quarter, volatility is a normal part of well-functioning markets. It can't be avoided. But long-term investment performance track records are made or broken by how one reacts in times of adversity. We did relatively little during the latest period of volatility because we had conviction in the names we held, derived from a significant amount of research on their competitive positioning, long-term growth prospects, financial strength and management capabilities. That conviction allowed us to avoid the cardinal mistake of panicking in the face of market declines. We weathered the storm and benefitted from a market recovery.

Market Rotation

As quickly as the markets dropped in July and August, they recovered in the succeeding weeks through the end of the quarter, but an interesting shift occurred during this period of market turmoil and recovery, which we view as positive overall for markets. Sectors that had underperformed for years became the driving force of the market's recovery. Industries like utilities, real estate, industrials and financials drove market gains, while technology lagged. Calculated on the basis where all companies contained in the S&P 500 index are weighted equally rather than by capitalization, the index was up by +9.6% in the quarter (+370 basis points better than the capitalization-weighted index). Dividend-payers, as represented by the S&P 500 Dividend Aristocrats Index, appreciated by +11.7%. Domestic small cap stocks, as measured by the Russell 2000 Index, rose by +9.3%. This broadening of leadership is healthy for a market long-term, particularly after a long period when seven "mega-cap" technology stocks disproportionately drove market index gains. We have been broadening our exposure as well in recent quarters. While we had exposure to AI-related stocks that came under pressure in Q3, our most recent acquisitions, purchased in the previous quarter, were in the industrial sector. Our most recent addition, discussed below, is in the consumer sector. We are still devoted fans of our technology positions, but we own them on their fundamentals rather than on a dream of what they might become in an AI-driven future. If they don't pencil out based on sales, earnings and cash flows over the relatively near term, then they don't belong in the portfolio.

Portfolio Changes

During the quarter we initiated new positions in LVMH Moët Hennessy Louis Vuitton SE (“LVMH”).

LVMH

LVMH is the world’s largest luxury goods conglomerate, operating in segments such as leather & fashion, wine & spirits, beauty, watches, and jewelry. This iconic company owns some of the world’s most renowned brands, including Louis Vuitton, Christian Dior, Hennessy, Sephora, and Tiffany.

LVMH’s economic moat is built on its ownership of differentiated and highly desired brands, which tend to attract wealthy customers. These brands give LVMH pricing power, resulting in healthy profit margins and high returns on invested capital. The group’s scale and diversification across categories and brands provide resilience and stability in various market environments.

We are also big fans of the management team. Founder and CEO Bernard Arnault is an exceptional investor and capital allocator. His family controls 64% of the voting rights, allowing them to focus on long-term brand desirability rather than short-term profits. Arnault’s approach to capital allocation is reminiscent of another prominent portfolio holding, Berkshire Hathway.

LVMH benefitted from the global spending spree following the COVD-19 Pandemic, but recently revenue growth has slowed due to macroeconomic pressures. The stock has been on a downtrend for the past year, and during the quarter reached a level we found attractive. We aren’t the only ones who noticed – Arnault himself has been aggressively buying the stock over the past year. Even four years after the pandemic, its shockwaves continue to create attractive opportunities for patient investors.

New to the Team

We made an important addition to the Summitry team during the quarter. Faced with the pressures that come from steady growth in the business, we searched outside of the firm to find a Chief Operating Officer with the experience and expertise to help the team architect our systems and processes for the future. We are in this business for the long haul, anticipate continued growth and strive for improvements in client service and satisfaction, as well as employee engagement and fulfilment. Conor Wilkes began his career as a commissioned officer in the US Navy after graduating from the US Naval Academy. He cut his teeth in our industry as a Private Wealth Management Associate at Goldman Sachs in San Francisco, then enrolled full time at the Haas School of Business at UC Berkeley. With a fellow Navy veteran, Conor established Anchorage Partners, a firm dedicated to leading and operating a single small business through its next growth phase. This background, in addition to some glowing references, made Conor a perfect choice for the new role at Summitry, and he has already made a substantial impact as we steer the business toward its new relationship with Evergreen Services Group. Conor lives in his native San Francisco with his wife Jess and daughter, Margot. A former rower with a seat in the Naval Academy’s eight-man heavyweight boat, he satisfies his competitive needs in off hours playing basketball in a league at San Francisco’s Olympic Club.