Principal Asset Management℠

PRINCIPAL ALIGNED SMA BLUE CHIP EQUITY

Quarterly commentary

FOURTH QUARTER 2023

The Principal Aligned SMA Blue Chip Equity portfolio outperformed the Russell 1000® Growth Index on a gross basis in the fourth quarter.

What helped

Microsoft and Amazon were the top two contributors. Both companies gave updates during the fourth quarter on their respective cloud businesses—Azure for Microsoft, AWS for Amazon—highlighting how they are integrating generative AI services into their platforms. Company selection in financials and industrials contributed most of the outperformance over the benchmark. Brookfield Corporation had strong performance. They are set to achieve their goal of $150 billion of fundraising this year. TransDigm finished the year strong. They announced another large acquisition last quarter and distributed a $2 billion special dividend.

What hurt

The portfolio did not have any companies with a negative return during the fourth quarter. The "detractors" mentioned below were just smaller contributors, with returns that trailed the rest of the portfolio. Used car retailer CarMax lagged last quarter. CarMax is doing a good job managing through the challenging environment for their industry, specifically seeing a positive impact from their omni-channel investments. Danaher had a small return in the quarter. The company completed the spin-off of its Environmental and Applied Solutions segment (now called Veralto, an independent public company). Danaher is well positioned to act on future life science opportunities. Despite strength in our software holdings (Microsoft, Adobe, Intuit), information technology was the sector that detracted most from relative performance

What we did

We increased shares of aerospace components manufacturer HEICO—a company first added to the portfolio in the second quarter of this year. HEICO has made smart acquisitions over the last two years, including the large one this year of Wencor. We trimmed our position in Moody's, a credit ratings and analytics business, to reallocate capital to other attractive opportunities.

Top five contributors

Microsoft's primary goal is to empower every person and every organization to achieve more. Their two largest businesses, Office and cloud platform Azure, continue to gain share as they make businesses more efficient. Microsoft helps its customers do more with less thanks to productivity gains and consolidation of spend. Satya Nadella and Amy Hood (CEO and CFO respectively) ensure Microsoft is focused on large and growing opportunities. Microsoft has numerous opportunities ahead, from Teams and Azure to advertising and gaming. Shares contributed to performance during the quarter.

Amazon is dominant in online retail and cloud computing. The long-term growth runway is attractive at Amazon Web Services, as more computing gradually moves to the cloud. In retail, Amazon benefits from the virtuous cycle of using its scale and logistics network to offer lower prices and a better experience for customers. The company is leveraging its platform to build a significant advertising business. Shares contributed to the portfolio's performance last quarter.

Brookfield Corporation is a global investor and asset manager, focused on real estate, infrastructure, renewable power and energy transition, private equity, and venture capital. The company's terrific management team, led by CEO Bruce Flatt, owns more than 18% of the company. They are long-term investors that seek opportunities to deploy capital counter-cyclically. Brookfield has a competitive advantage with its global footprint and deep capital base. The company continues to have both investing and fundraising success. Shares contributed to performance.

TransDigm is a supplier of an extensive collection of airplane components led by a highly respected management team. Nearly all military and commercial aircraft have parts made by TransDigm. The business has high barriers to entry—approximately 90% of TransDigm's parts are proprietary, and TransDigm is the sole provider of about 80% of them. Its aftermarket business—selling replacement parts to the owners of aircraft—is exceptionally profitable. Shares increased during the quarter and contributed to performance.

American Tower is an owner and operator of multitenant communications real estate. They own approximately 225,000 cell phone towers and communication sites globally and lease antenna space on these towers to wireless service providers. These long-term contracts make for a very attractive business, with steadily growing cash flow. American Tower also operates 28 data centers across the U.S. The company benefits from global growth in mobile data usage. With American Tower's unmatched scale, the company is the natural provider of choice for global telecom firms. Shares increased in the quarter.

Top five detractors

CarMax is the largest used car retailer in the U.S. with more than 240 locations. CarMax purchases, reconditions, and sells used vehicles. They also operate wholesale auctions on their store lots and provide financing to their customers through CarMax Auto Finance. CarMax's omni-channel strategy integrates the online and in-person experience seamlessly to deliver a high-quality personalized customer experience. CarMax continues to gain market share due to its broad capabilities, footprint, and respected brand. The company has managed well through challenging used car industry conditions, including higher used car prices and tighter financing. Shares were up last quarter, but it detracted from performance due to its small weight and relatively small positive return.

Intuitive Surgical is the pioneer in robotic-assisted, minimally invasive surgery. The company is innovation-focused, with a high-performance culture. Intuitive has a competitive advantage with its ecosystem—they provide the robot, instrumentation, data analytics and hospital support. With its da Vinci surgical system launched back in 2000, Intuitive Surgical has more data and documented outcomes than recent market competitors. Shares increased during the quarter, as procedure volumes rebounded from lower levels during the pandemic, but its small weight in the portfolio limited its contribution.

NVIDIA is the leading manufacturer of graphics processing units (GPUs) which are used in gaming, data centers, automotive, and professional visualization. GPU applications have extended to artificial intelligence, virtual reality, and high-performance computing. NVIDIA is well positioned to enable advancements in AI from a hardware perspective. NVIDIA's software applications over time, have potential to be as large of an opportunity as its primary hardware business. Shares had a positive return during the quarter, although below the index's return, limiting its contribution to performance.

HEICO Corp. is one of the largest manufacturers of FAA-approved jet engine and aircraft component replacement parts. With a unique owner-operator culture, HEICO has developed design and manufacturing processes that allow the company to offer aircraft component replacement parts below the cost of many OEMs. In addition, the company has significant intellectual property either through reverse engineering or acquisitions, thus creating barriers for meaningful competition to enter. Shares had a positive return but detracted slightly from performance during the quarter.

Danaher is a portfolio of twenty global science and technology businesses that benefits from leading competitive positions, long-term growth trends, and revenue that tends to be recurring in nature. Founded by Mitch and Steve Rales, Danaher has achieved tremendous success over decades by buying good businesses and continuously improving them with its kaizen-style Danaher Business System. The Rales brothers remain involved (Steve is the chairman) and collectively own more than 10% of the company. Shares detracted from performance.

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