

SMA BLUE CHIP EQUITY

Quarterly commentary

FIRST QUARTER 2025

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

What helped

The financial sector was the top contributor to Blue Chip performance in the first quarter, led by insurance carrier Progressive. Progressive increased prices earlier than competitors, which allowed them to step up advertising. Progressive gained market share in a profitable way. O'Reilly contributed to performance. As a leading auto parts retailer with non-discretionary products, O'Reilly managed well through fluctuating economic conditions. Diversified technology company Roper performed well during the quarter. In March, Roper continued to deploy capital and announced the acquisition of a vertical market software company that fits well with its portfolio. On a relative basis, having less exposure to the Magnificent 7 companies helped performance.

What hurt

Uncertainty around AI-spending plans and price sensitivity emerged during the first quarter. Alphabet, Amazon and Microsoft announced increased capex targets. They are going through a period of increased investment, that has a lag in returns. As long-term owners, we like to see our companies investing in future growth. On a relative basis, having little exposure to health care, staples and energy detracted from performance.

What we did

We bought Idexx Labs in the SMA Blue Chip portfolio during the quarter. Idexx is a leader in pet health care with diagnostics and software products for vets. We increased shares of Airbnb and Broadcom. Intuit was sold from the portfolio. Intuit has competitive advantages in its tax and accounting products, but as its business matures, we decided to use funds for other attractive opportunities.

Top five contributors

Progressive is one of the largest insurers in America. The company's roots were in providing car insurance to people that most other companies would ignore, typically due to poor credit and accident history. Progressive saw that with enough data and analytics, they could still underwrite this group profitably. They developed an innovative, data-driven culture and effective direct-to-consumer marketing while keeping costs low to be able to offer lower prices. Today Progressive offers a full suite of insurance solutions including vehicle, homeowners, property, commercial and personal lines, while maintaining its innovative, cost-efficient culture. Progressive's shares contributed to performance.

O'Reilly is a leading auto parts aftermarket retailer, serving both consumers who repair their own vehicles and professional mechanics through their more than 6,300 stores in the United States, Mexico, and Canada. O'Reilly's investments in distribution centers have put them in a position to quickly deliver a massive array of inventory in a way that competitors cannot match. O'Reilly benefits from the owner-operator culture that is prevalent from the O'Reilly family's leadership to its distribution centers and individual stores. O'Reilly shares rose during the quarter.

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. Demand for replacement parts was strong due to the slowdown in new aircraft manufacturing. Shares contributed to performance.

Visa is a dominant global payments company, with over four billion cards and 150 million merchant locations, in more than two hundred countries and territories. The scale of Visa's global infrastructure is tough to replicate and serves as a barrier to entry. The company provides a trust layer for merchants and consumers when card payments are made. Visa benefits from the strongest network effect in the industry. Ubiquity of acceptance leads consumers to want to use Visa cards, banks to issue the cards and drives increasing acceptance for the marginal merchant. Visa's shares contributed to performance last quarter.

Roper Technologies owns a diversified group of about 30 companies, many of which are software businesses. While each business serves a different market—from cashless campus software to insurance technology to water meters—they tend to be a leader in a niche industry, with high recurring revenues and gross margins. Roper is very decentralized, with few people at headquarters. The company benefits from a culture focused on accountability and continual improvement. The management team at Roper has a history of effective capital allocation. Shares rose during the quarter and contributed to performance.

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Top five detractors

Alphabet is the parent company of a collection of businesses, including Google Search and YouTube. Despite dominant share, management still highlights Search as its biggest opportunity in the future. Twenty years on, the company continues to invest billions of dollars each year into the Search business, with AI embedded into its software and infrastructure. There is also significant opportunity to increase the monetization of YouTube, the dominant video streaming platform that benefits from network effects. Alphabet's shares detracted from performance.

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 has a long runway of opportunity in advertising. Shares detracted from performance.

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, incorporating its AI Copilot across its platform. Shares detracted from performance during the quarter.

Broadcom focuses on technologies that connect our world. Led by visionary owner-operator Hock Tan, Broadcom has an extensive portfolio of category-leading products in each of its semiconductor and infrastructure software franchises, with the scale and engineering talent to lead the industry into the future. Broadcom is well positioned for the next wave of spending in AI infrastructure, making custom AI hardware for the world's largest companies. Its other businesses have significant opportunities, from integrating VMware's infrastructure software tools, to broadband solutions, industrial automation, server connectivity and cybersecurity. Broadcom's advantage is its intellectual property, talent, and track record of execution. Shares detracted from performance during the quarter.

Cadence is a leader in electronic design automation software for the semiconductor industry. The company provides essential software for an essential industry but is a small part of the overall cost. Breadth of products and industry partnerships are difficult to replicate. With high barriers to entry and competitive advantages, Cadence has very high customer retention. The company has a long runway for growth ahead due to major digital trends including AI and machine learning, hyperscalers, IoT, 5G, and autonomous driving. Shares sold off during the quarter, following strong performance the previous quarter. The outlook for the business is strong.

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