

PRINCIPAL ALIGNED SMA BLUE CHIP EQUITY

Quarterly commentary

FIRST QUARTER 2024

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

What helped

Consumer discretionary was the top performing sector, led by Amazon. In February, Amazon reported accelerating revenue growth in both its Retail and AWS Cloud segments. Company selection in the industrial sector also contributed to performance, led by aerospace components business TransDigm and vehicle salvage and auction company Copart. Progressive continued to post impressive results, beating profitability targets. In February, the company released its annual letter to shareholders and attributed success to its people and culture. Netflix had strong performance last quarter. Its twenty-year lead over streaming competitors is a significant advantage. Netflix was able to increase content spend as competitors cut back.

What hurt

Adobe sold off in March when their near-term guidance fell short of Wall Street's hopes, which were based on recent AI-related excitement. Adobe's results were strong. It's clear when talking with Adobe's management they're focused on positioning the company for the long-term AI opportunity, rather than going for, as their CFO puts it, a 'sugar rush'. Also in information technology, having a smaller weight than the index in Nvidia hurt performance relative to the benchmark. Animal health businesses Zoetis and Idexx detracted during the quarter, following strong performance at the end of last year. Both companies continue to innovate and invest in their businesses.

What we did

We added more shares of Danaher, a portfolio of diverse businesses across biotechnology, diagnostics, and life sciences. Danaher is an owner-operator led company with a culture of operational excellence. We trimmed shares of S&P Global to allocate capital to other 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, incorporating its AI Copilot across its platform. Shares contributed to performance during the quarter.

Amazon is dominant in online retail and cloud computing. The long-term growth opportunity 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 contributed to performance last quarter.

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 positively 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.

Netflix is the leading streaming entertainment service with more than 250 million subscribers in over 190 countries. With an influx of new streaming players in the U.S., the company's scale is a competitive advantage. Netflix can outspend rivals on content and still earn better returns on the expenditure, creating a flywheel effect. The company continues to evolve its strategy and is building up its advertising business. Netflix has a unique culture and focus on long-term outcomes. Shares contributed to performance.

Information is based upon a model (hypothetical) portfolio of the Principal Aligned SMA Blue Chip Equity strategy. The holdings identified do not represent all of the securities purchased, sold or recommended for the model portfolio during the quarter. It should not be assumed that recommendations made in the future will be profitable or equal the performance of the securities listed. Past performance is no guarantee of future results. This commentary may exclude minimal security positions that the investment adviser deems of insignificant or no material impact to the portfolio.

Top five detractors

Adobe is the market leader in software for creative professionals worldwide. Its primary software, referred to as Creative Cloud, is necessary for creative professionals to do their jobs, such as website design, video editing, or the well-recognized Photoshop. Document Cloud, which includes the Acrobat PDF products, continues to transform document sharing capabilities for the hybrid work environment. The demand for digital marketing is growing into a significant opportunity for Adobe as businesses realize having a commerce and marketing presence on the web is critically important. Adobe's shares detracted from 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 detracted from performance.

Zoetis is a leading animal health company, with vaccines, medicines and diagnostics for companion animals and livestock. The company's operating philosophy of "first to know and fast to market", drives the innovative culture and attracts the best talent. Zoetis' consistency in bringing innovative products to market has led to market share gains and pricing power. This allows Zoetis to invest more in animal health research and development and develop closer customer relationships than its competitors. Zoetis has a strong pipeline of products in development to add to its Pain, Dermatology and Parasiticide franchises. Zoetis detracted during the quarter.

S&P Global is a global information services company providing credit ratings, benchmarks, analytics and workflow solutions. The S&P Global Credit Ratings business, where S&P has roughly 40% global market share, has high barriers to entry, with a concentrated industry structure. The S&P Dow Jones Indices offerings serve as the basis for ETFs, futures, options, and other investable products around the world. Last year, S&P Global surpassed its synergy target from the 2022 merger with IHS Markit, bringing complementary assets together, adding financial market data and analytics capabilities. Shares declined during the quarter.

IDEXX Laboratories is a leader in diagnostics for companion animals, providing testing capabilities in the offices of veterinarians and in their reference labs. As the dominant provider, IDEXX can invest substantially more than competitors in both R&D and their salesforce that calls on veterinarians. The testing business is very attractive, with substantial gross margins and nearly all the revenue being recurring in nature. IDEXX also stands to benefit from the tailwind of more money being spent on the health of pets. Shares detracted from performance last quarter.

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