Principal Asset Management[SM]

SMA MIDCAP EQUITY

Quarterly commentary

FIRST QUARTER 2025

The Principal Aligned SMA MidCap Equity portfolio outperformed the Russell Midcap Index on a gross basis in the first quarter.

What helped

Auto Parts retailer O'Reilly delivered strong performance during the quarter. With non-discretionary products, and the ability to pass through rising costs to the consumer, O'Reilly is well positioned to handle changes in the economic environment. In March, Executive Chairman Greg Henslee celebrated forty years at O'Reilly. He highlighted the benefits of O'Reilly's promote-from-within philosophy, and core values established by the O'Reilly family. Family-run insurance broker Brown and Brown operated well. They were disciplined on M&A combined with good organic growth. Brown and Brown's scale is a competitive advantage in a fragmented market. Aerospace components businesses HEICO and TransDigm have benefitted from the slowdown in airplane manufacturing from the original equipment manufacturers. Demand for aftermarket replacement parts was robust.

What hurt

After strong performance in 2024, alternative asset managers KKR and Brookfield pulled back during the first quarter. Initial excitement around accelerated asset monetization cooled in the past few months. Despite the change in sentiment, fundamentals have not changed. Both KKR and Brookfield have significant competitive advantages, led by owner-operators, with a history of fund-raising success. Hilton sold off during the quarter following news of an industry-wide slowdown in bookings. This is a cyclical business, and Hilton is one of the most competitively advantaged companies. In a downturn, relative performance can get stronger for leaders like Hilton. On a relative basis, lack of exposure to electric utilities and energy companies detracted from performance.

What we did

We bought Toast in the SMA MidCap portfolio. Toast is a leader in technology servicing the restaurant industry—an industry that has been slow to adopt new technology. Led by a passionate founder who owns a significant amount of shares, Toast is seizing the opportunity to bring the restaurant industry up to modern standards. Air Products, LPL Financial, and AppFolio were added to the portfolio. We sold Microchip, Autodesk, Verisign and SBA Communications to allocate funds to other attractive investments.

Past performance is no guarantee of future results. Investing involves risk, including possible loss of principal.

Top five contributors

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. Shares contributed to performance.

Brown & Brown is one of the largest independent insurance brokerages in the world. Its four business segments - Retail, National Programs, Wholesale Brokerage, and Services - offer insurance products and risk management solutions to individuals and businesses, in over 500 locations. Founded more than 80 years ago, J. Powell Brown is the third generation of Brown's to run the business. The company has an entrepreneurial performance-based culture and is able to out- grow competitors based on strength of its producers. Brown & Brown was active making acquisitions last year. Shares contributed 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. Recent acquisitions have increased visibility into future growth of the business. Demand for aftermarket parts was strong, due to the slowdown in new aircraft manufacturing. 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 contributed to performance.

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. Shared increased last quarter and contributed to performance.

Information is based upon a model (hypothetical) portfolio of the Principal Aligned SMA MidCap 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

KKR is a global asset management firm with leading capabilities in private equity, credit, and real assets. The company stands apart by aligning interests at all levels, including significant insider ownership of KKR shares. The distinctive way KKR operates allows them to focus on the most profitable opportunities. Their attractive investment track records have enabled them to continually raise larger funds, which are frequently oversubscribed. KKR spent more than a decade developing capabilities outside the U.S., with a regional approach in the Americas, Europe, and Asia. Fundamentals of the business remain intact despite sell off in shares. KKR detracted from performance.

Hilton manages and franchises a portfolio of hotels with more than 8,400 properties under 24 brands, in 140 countries and territories. They have leading brands in every category, from Waldorf Astoria on the high end to its value-driven offering, Spark by Hilton. Historically Hilton owned many of its properties, but today the company is primarily an asset light business as a franchisor and manager. Hilton has a strong network effect, generating better returns for hotel owners, which attracts more capital and allows them to build out their network further. Shares detracted from performance.

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. Growth is coming from private credit, AI infrastructure and energy transition. Shares detracted from performance.

Gartner provides industry specific research to assist senior leaders in making mission critical business decisions. The breadth of customers and vendors that Gartner works with creates a network effect of insights that competitors cannot match. Gartner's CEO, Gene Hall, owns $500 million of stock and is responsible for Gartner's growth strategy that was implemented when he became CEO 20 years ago. Gartner has detracted from performance due to a more difficult selling environment. Historically Gartner has done a good job of minimizing external headwinds through prudent expense management.

Vulcan Materials is the nation's largest producer of construction aggregates such as crushed stone, sand, and gravel. It is also a major producer of asphalt mix and ready-mixed concrete. With its coast-to-coast footprint, Vulcan enjoys a significant scale advantage and high barriers to entry due to zoning and permitting regulations, limited substitute products and its irreplaceable asset base. Vulcan's strategic initiatives support both near-term performance and longer-term competitiveness. Shares detracted from performance.

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