JENSEN®
INVESTMENT MANAGEMENT

TRANSCRIPT
JULY 2024

Quality Growth Fund Quarterly Update: 2Q 2024

Hosted by Rob McIver, Managing Director, President & Portfolio Manager; and Jannis Fingberg, CFA, Business Analyst

ROB MCIVER: Good morning, everyone. Thank you for joining me, Rob McIver, one of the co-portfolio managers for the Jensen Quality Growth Strategy. And today I'm joined on the webinar by my colleague, Jannis Fingberg. Today, I will begin with a brief overview of our firm and investment philosophy. Jannis will cover quarterly performance trends and portfolio changes.

I will then conclude our remarks with some comments on the market trends and our outlook. We will wrap up with a Q&A session, as Gabby mentioned. Please feel free to use the Q&A button on the webinar portal. Founded in 1988, Jensen is an independent, employee-owned investment management company, focused solely on quality investing strategies. And 23 of our 43 employees are shareholders in the firm.

As of June 30, 2024, we managed approximately $12.4 billion of assets. We also oversee an additional $1.7 billion of assets under advisement, for a total of about $14 billion across three strategies. The Jensen Quality Growth is our flagship, large-cap equity strategy focused on the long-term ownership of high-quality, value-creating U.S. businesses.

The strategy was launched with the founding of our firm in 1988 and has been available in mutual fund form since 1992. The composite for the Jensen Quality Mid-Cap Strategy was launched in 2008, and the fund version was launched in 2010. It shares many similarities with Quality Growth, but is focused primarily on mid-sized U.S. businesses.

The Jensen Global Quality Growth Strategy is our third product that we launched in April 2020, and it represents an extension of the U.S.-based Quality Growth model, but with an expanded investable universe that includes high-grade overseas companies. Our investment philosophy is the foundation for our performance and our portfolio characteristics and informs our comments today.

Listen to the webinar at:
www.jenseninvestment.com

Questions? Contact us:
clientservices@jenseninvestment.com
800.221.4384

Our approach is best thought of in terms of investing in first-class growth businesses that have long histories of creating strong and consistent shareholder value. Here at Jensen, we invest with a risk-first mentality. And we focus our fundamental research efforts in identifying quality attributes that we believe represent the engines of sustainable corporate growth, as evidenced by a minimum return on equity of 15% over 10 consecutive years. This demanding ROE hurdle helps us identify companies with durable, competitive advantages and free cashflow generation that can be deployed to reinvest in future opportunities. We favor business models that have demonstrated resiliency in a variety of market and economic environments.

We believe this focus mitigates business risk, the first of the two main risks facing investors. The second major risk we seek to manage is pricing risk. And consequently, valuation represents an important component to our process and, we believe at times like this, differentiates us. The importance of valuation is twofold. First, we believe that investing with a margin of safety is a critical part of long-term pricing risk management.

For Jensen, that means we will always seek to purchase and hold a company's shares that are priced at a discount to our measure of full value. Second, we invest at a price at which we believe there will be a long-term correlation between the value created by a business and the growth in its share price. Based on our experience, this relationship is not always linear, but we do want to avoid the risk of overpaying for our investments.

In terms of timeframe, we're most comfortable being measured against a full economic and start market cycle, which we define as one peak in the market to the next peak. We favor this performance timeframe because it typically encompasses periods that allow the fund's participation in an appreciating market environment and, importantly, the opportunity to protect capital in more volatile times.

We'll return to this topic later in our presentation, as we comment about longer term performance trends. And with that, I will now turn the call over to Jannis to discuss quarterly investment performance, attribution and portfolio changes.

JANNIS FINGBERG: Thank you, Rob. Great to be on the call. Second time for me. Some of you may remember me from a similar call I did with our head of research, Allen Bond, at the end of last year. For those of you who hear me speaking for the first time, my name is Jannis. I have been a fundamental bottom-up, long-term-oriented investor for about 15 years now, including several years spent in London, Hong Kong and San Francisco.

I'm excited to be here at Jensen and look forward to getting to know more of you listening in today over time. Okay, so looking at the investment performance of the quarter. So for the second quarter, the Jensen Quality Growth Fund produced a total return of 1.3%, underperforming the S&P by around 300 basis points. You see that on the slide, if you look at the left-most column.

In general, I would say that a quarterly assessment is arguably not the best timeframe for assessing a long-term-oriented strategy such as Jensen's, but my colleague, Rob, will go into more detail in terms of how to think about the long-term performance at a later point in the call. At a high level, returning to the second quarter, the second quarter's underperformance is largely, in our view, a continuation of the past six quarters, during which the market focused primarily on a handful of generative AI stocks at the expense of the broader market. As an aside, while this call is about the second quarter, I'm sure many of you have seen how the market sentiment and performance has changed over the last week or two.

Now, that is an even shorter period of time, not necessarily sensible to look only at that in isolation. But nevertheless, it does show how quickly sentiment can change. Nvidia, which is currently not owned by the portfolio, has contributed around 800 basis points to the index's return over the last six quarters, accounting for a significant portion of the underperformance the portfolio has experienced during this time. In our experience, and here I would really say that one thing that is special about Jensen, is really that it has applied the same consistent investment philosophy and process for over three decades.

And this degree of relative underperformance is uncommon and clearly not what we want. But at the same time, the firm has observed similar instances in the past, and has usually seen a recovery subsequently. We believe

that in times like these, sticking to Jensen's long-term oriented, time-tested investment strategy ultimately bears fruit, as it has done through many prior cycles.

This chart, Style Factor performance, it looks a bit confusing at first glance, but essentially it shows the factor performance. So it shows the Style Factor attribution in the second quarter for the broader market. So at a high level, it shows that momentum-driven stocks, if you look at the very bottom, were in favor.

If you look at the momentum at the bottom, the graphs are all to the right. Whereas the picture for growth and particular quality further up is more mixed. On the one hand, companies with a high return on equity and high net income were in favor. Here, I think, it would be a fair pushback from maybe some of you listening in the sense that, Jensen, of course, we do focus on companies that have a high, not necessarily the highest, but a high and consistent return on equity. However, a more nuanced, detailed analysis again revealed if you look at the underlying data behind this graph, again, this was more driven by Nvidia and other semiconductor stocks that the fund did not own.

Other quality attributes, such as sales growth stability and earnings growth stability, were not in favor. The picture regarding growth was also more nuanced. On the one hand, several growth attributes that Jensen favors, were in favor. No. I mean several growth attributes were in favor, excuse me, but dividend growth was actually not.

And as many of you know, the Jensen strategy often favors stocks that have a history of consistent dividend growth and dividend stability. So overall, the point is really that we would argue that traditional Jensen quality stocks were actually not in favor during the quarter. Now that being said, don't necessarily just take our word for it, but the picture of traditional quality stocks having been out of favor was also confirmed by another third-party data provider, S&P. Accordingly, the portfolio's overweight position to high-quality stocks detracted from its benchmark-relative return, as investment performance from higher-quality stocks trailed that of lower-quality stocks.

As you would expect, the portfolio was significantly overweight to higher-quality stocks versus the index according to S&P. Now, we believe that there are certainly periods when low-quality businesses can outperform. But we believe that over a full market cycle, investors in higher-quality business have the potential to be rewarded with better returns and lower volatility, as has historically been the case for Jensen's investors.

Moving on to the next slide, attribution analysis by sector. So at a sector level, the portfolio selection within the Information Technology and Consumer Discretionary sectors was the largest detractor from relative investment performance. You see this on this table, if you look at the stock selection effect column, it's all the way to the right.

On the positive side, the portfolio security selection in the Communication Services sector and the lack of exposure to stocks in the Energy and Real Estate sectors boosted relative performance. Due to inconsistent profitability, there are very few companies in either of these sectors that qualify for the Jensen investable universe. The portfolio's underweight in the Financials sector also contributed to performance. That you can see if you look at the sector allocation effect column. Now, I would like to go into a little bit more detail here, and offer some examples of companies that drove negative or positive contribution within the various sectors. So in the Information Technology sector, Accenture was actually the worst individual contributor.

I will talk about Accenture separately, but suffice it to say for now, we maintain long-term confidence in the company. Indeed, even though this presentation is about the second quarter, we have observed since the end of the second quarter until now, a recovery in Accenture's shares. The second-largest detractor was not owning Nvidia.

Microsoft had the best positive contribution from stock selection in Information Technology, followed by KLA. Not owning Salesforce, which performed poorly, also contributed positively. In the Communication Services sector, owning Alphabet was the key positive contributor. I'll speak to that separately, and not owning Meta also contributed meaningfully in a positive way.

Alphabet was the top individual positive contributor during the quarter. I would want to take a few minutes to highlight some aspects about the company. Everybody

knows Alphabet. All of you very likely use one or several of its products for today and probably have so for many years, whether it's Google search, YouTube.

Perhaps you have an Android-based phone, or perhaps your company stores its data in Google's cloud. Now, the company has performed strongly during the second quarter for reasons including earnings. The company reported strong, top-line growth and strong earnings. Importantly, it initiated its first dividend, which was very positively received by the market.

Part of that is also because once a company starts to issue a regular dividend that opens up, it basically becomes eligible for a whole different category of investors. In addition, the company increased its buyback authorization for shares. Finally, and perhaps most importantly, we would argue in the long term, the market has arguably started to realize that Google is actually one of the most strongly positioned companies when it comes to artificial intelligence.

Now, this may sound obvious in a way, but that was not the consensus view, for example, during Q1, where the company or even prior to that at certain moments when, for example, ChatGPT came out, people were increasingly concerned that might disrupt Google's traditional search business. Coming back to why it is actually positioned strongly in artificial intelligence in our opinion.

At a high level, think about what is needed to be successful in artificial intelligence. One, you need very deep pockets, so it's incredibly expensive to compete successfully in AI. You need vast processing power. Google has historically always had the strongest processing power and continues to be a, if not the, leader here. Critically, you need lots of data.

Google has an unparalleled amount of data accumulated over the years via search, Gmail, YouTube and Android, just to name a few. Now, as I mentioned, as with any company, Google faces a range of risks. One risk that has been more prominently discussed these days, is the risk of disruption of its traditional search model, which in our view, is a valid concern.

The concern here is essentially that, for example, if you take ChatGPT, why continue to use Google search if you can just ask ChatGPT? The interaction with ChatGPT is arguably more natural. You literally put in the question the way it comes to your mind. You don't need to think about, "Oh, which keyword do I ask?" You get an answer that critics have put out a lot of information regarding hallucinations and wrong answers.

But certainly in my personal experience, more often than not, the answers I get are actually really good and comprehensive, and answered in a more detailed way than maybe traditional Google search. So it is a valid concern. We wouldn't just dismiss it. That being said, right now, if you look at market share data in search, the share taken by ChatGPT and others from traditional search is minimal.

At the same time, and probably more importantly, because obviously that can change over time. But more importantly, we believe Google is well positioned to adapt and harness AI to its advantage. Google has actually its own powerful AI models, for most, a model called Gemini. As I'm sure many of you have seen when searching something in Google, you often get a Gemini AI summary at the top of your search screen.

Over time, our understanding is that Google will continue to roll this out. And then in the longer term, if you think about what more user interaction with generative AI essentially means more context for Google and its models. So basically when you enter a full question to an AI model, it usually conveys much more information to Google or whatever AI company, than when you just enter a search term in traditional Google search.

So better context in the long term will actually lead to better ad targeting for Google, which is one of the key aspects of their business model. A different angle to illustrate the competitive strength of Google is really just an anecdote. If you look at the Department of Justice in the U.S. is actually really worried that AI will not disrupt a Google search.

They believe that AI advancement will actually be dominated by Google due to its scale and first-party data advantages. Now, while we don't base our research in government agencies, it's nevertheless an interesting anecdote.

Moving on to Accenture. I guess moving from the good, the strong performance of Alphabet, to the less good Accenture. Less good not as a fundamental assessment

of the company, but just the performance in the second quarter.

Accenture was the worst individual contributor, as I mentioned. It's also a well-known firm, of course. Global IT firm offering consulting, IT implementation, business outsourcing services. Share price has been weak. We attribute that to generally across firms in this sector, not only Accenture. In fact, Accenture fared better than most of its competitors.

Corporate IT spending and demand has been weak for the last 18 to 24 months. Now, that is due to a combination of companies being cautious in terms of an uncertain macroeconomic environment. At the same time, a lot of companies, just like all of us, they see share prices of Nvidia increase like something they've never seen before.

If you're sitting in a large corporation and IT department, you certainly start to wonder, "Maybe there is something real to AI. Maybe we should look into this. Oh, we don't have the capabilities and the employees right now to do it. Well, let's get some external, Accenture can then help." But initially, you're not going to go all in, so to speak. You start with a small project.

You have to negotiate. Your IP budget is probably set at the beginning of the year, so you can't just increase it without C-suite approval. So overall, there is interest in AI and Accenture's results showed that. AI-related bookings grew rapidly, but from a very low base. That being said, overall, when we look at several data points that we track when we look at competitors.

When looking potentially then from a services perspective, IT services perspective, we believe that we're closer to the bottom. One specific, encouraging data point here was from a company called Tata Consulting Services, TCS, which is a large Indian competitor to Accenture. They recently stated in their results that they see the demand environment for IT projects stabilizing and potentially, cautiously improving.

Another thing to consider here is regarding the whole AI topic and spending on projects for it, is that any new technological development, getting approval to do projects in that area. Getting all the key stakeholders in a company to agree to really invest in that area, that is a slow and usually challenging process that takes some time for people to get convinced. That is not a new phenomenon either.

This is not specific to AI at all. If you look at the last major technological development, arguably cloud computing. Cloud computing came out at some point around 2010, but it took some time for companies to really embrace it, and we see a similar dynamic with AI-related projects. As an aside, by the way, talking about cloud, only 30% to 40% of all companies are fully in the cloud as of now.

There is still significant potential for cloud transformation projects as well, which is one of the key areas that Accenture focuses on. We believe this area will accelerate, because basically in order to really implement AI-related projects, you first need to have your data in the cloud. So cloud transformation is almost a precursor to AI transformation.

Another aspect to highlight is that Accenture is really investing countercyclically, which is something is a theme that will come back later on. Like many great companies, they basically invest in the tough times to be ready for the good times. Sounds logical, but easier said than done. Many companies fail to do so. Accenture is one of the ones that does do so.

They announced a $3 billion investment to get their stuff AI ready, so overall, poor performance of Accenture so far this year is disappointing, but we maintain conviction the long-term prospects of it. The company is definitely not broken. It's a best-in-class company. One of Jensen's advantages, we would argue, is the ability to take a longer-term view.

And indeed, while it's early days, so don't come necessarily back to me next call and say, "Oh, it hasn't happened." I don't make any predictions regarding short-term share price performance. Nevertheless, Accenture actually has started to outperform. Well, we'll see if there's loss or not, but the point is fundamentally, the company is on the right track in our opinion.

Briefly, mindful of the time looking at the portfolio changes. So we initiated a new position in a company called Sherwin-Williams. I'll speak about that one in more detail in a moment. We added a little bit more to KLA. We sold Moody's, trimmed Home Depot, Starbucks and Nike. Moody's is a global risk assessment firm best

known for its investor services and is a mostly known and global leader in the issuance of credit ratings. We very much retain a positive view of the company, but sold the position due to valuation considerations. We trimmed Home Depot, primarily because we saw a stronger growth and stronger quality in Sherwin-Williams with arguably, at least to a degree, similar underlying drivers.

Overall, we think of that as a quality and growth update for the portfolio. We reduced Starbucks. The company is facing a range of challenges, including a weakened U.S. consumer less willing to pay for very expensive coffee. There are also questions and concerns about its China expansion strategy and the likely success of it. We reduced Nike, we do not believe that the company is broken, but it's certainly challenged on multiple fronts, including from stronger competition, a weaker consumer both in the U.S. and in China, and potential leadership challenges. Although this is certainly a stock I would say that within the investment team, it leads to lively debate. But I would summarize it as we do not believe it's broken, but it certainly has a range of challenges that we're closely monitoring.

We did initiate a new position in Sherwin-Williams. Sherwin-Williams is a leading manufacturer and retail of paint and coatings to professional and retail customers. The company is the leading low-cost producer with superior scale across more than 130 manufacturing and distribution facilities in more than 120 countries. Selected competitive advantages, as you know, the first thing in our investment process is really understanding the fundamentals of the business and the competitive advantages.

And then separate to that, we go out and do our valuation work. This is not obvious, many firms operate the other way around. They will start with, "Oh, what looks cheap? What has underperformed, et cetera?" Then see if the company, if the market is correct in its assessment or not. Here at Jensen, it's the other way around.

We start with a really thorough analysis of the business fundamentals. And then once we, as a team, agree that this company in theory is an investment candidate, we put it on what we call the bench, like basically a list of candidates. And then the analyst does the valuation work and monitors the company.

Then over time, that can be potentially if there's a sell off, et cetera, there can be a moment when it makes finally sense to buy the company. Coming back to the competitive advantages for Sherwin-Williams, so those include size, scale and service. One interesting aspect that I personally did not know about before, is that for a professional paint job, the key cost is labor: 80%-plus of costs are labor related. So one wants to make sure that labor is used as efficiently as possible. This means that one needs to make sure that the right paint is ready for painting at the right time. Sherwin-Williams has figured out a way so that its professional customers have the right paint at the right time more effectively than any of its competitors.

Its store footprint, the largest one helps. Experience helps, superior IT systems help. So in some way, rather than thinking of Sherwin-Williams as they sell paint, another way is to think of them as they really sell a service, i.e. the integrated business model from manufacturing to store. The company has almost 5,000 company-owned stores to distribution.

There are over 3,000 Sherwin-Williams trucks driven by Sherwin-Williams employees. It makes them best at having the right paint, at the right place, at the right time. Now, the stock actually has underperformed the S&P by roughly 18% over the last quarter and year to date, as the market expected higher for longer interest rates. Again, it's funny how quickly the market can change its assessment.

This was, of course, true until very recently. This sell-off that happened because of that assessment by the market at that time, gave us the opportunity and an adequate margin of safety to initiate a position in the stock. So, this is really an illustration of what I was saying, that the company first was for a long time, I remember and the investment team was being closely monitored, it wasn't on the candidate list as a potential investment. But the valuation wasn't quite right or certain investment member teams had concerns regarding interest rates, regarding the economy, et cetera. But overall, at some point, the time came when the lead analyst on this stock really made the case saying, "Now I believe it's the time to really buy this stock."

That was an example of our process in action. Sherwin-Williams is trading at 25 times P/E compared to the five-year average P/E of 26. But one thing is that Sherwin-

Williams, coming back to the theme of Accenture where Accenture has invested in the bad times, same thing at Sherwin-Williams. So, Sherwin-Williams made, in contrast to its competitor, a major investment.

Really, so that basically means that the current earnings do not reflect its actual earnings power. Let me emphasize one final point. I guess just like in asset management where everybody knows that in theory, you must buy low and sell high if you achieve it consistently over time. And a similar effect can be achieved, can be observed in the corporate world.

So in theory, businesses should invest in tough times. In practice, it's often the other way around. Not at Sherwin-Williams. Here management has an impressive track record of counter-cyclical investment, which can be an important differentiator versus other businesses. And often a good predictor of long-term success of a business. And with this, let me hand back to my colleague, Rob.

MCIVER: Very good. Thank you, Jannis. We'd like to spend the balance of today's call on our outlook. As we consider inflationary pressures, current and future monetary policy, and the overall economic and political environment, plus the comments that we hear back from our portfolio companies, I think it's fair to say that our current outlook remains cautious.

Given the uncertainties facing investors, the market's return has certainly been robust. And at a high level, support has been provided by a decline in the 10-year U.S. treasury yield from a high of 5%. Solid evidence of a significant capital spending on artificial intelligence. The hope that after a flat performance in 2023, corporate earnings will see gains with expectations of a more dovish Federal Reserve.

Likewise, this year's U.S. elections are extraordinary in the number of associated black swan events and their magnitude. In recent weeks, the Republican presidential nominee was convicted of crimes and shot and almost assassinated. The current president has shown severe signs of aging that have raised questions about his ability to manage the stress of the job of governing.

And in the past three weeks, the Democratic Party has been in open rebellion, focusing on how the current president may be replaced on his own party's ticket. In terms of geopolitical concerns, we consider those to be still relevant. The benign character of much of the last decade that has been so supportive of global capital markets, namely low inflation, low-to-negative interest rates and a stable geopolitical environment, is over.

A number of commentators are of the view that we've entered a second Cold War, with the West facing challenges from China, Russia, Iran and North Korea. We are witnessing wars in Eastern Europe and the Middle East, and the threat of hostilities breaking out elsewhere. In short, we appear to be living in a much less certain era.

And we can no longer rely on the stability that has been supportive of a globalized economy in free trade. Longer term, the risks of trade tariffs, isolationism and the widespread adoption of policies by national governments that prioritize national security over economic efficiency, has made for a less forgiving background that is rapidly becoming the new normal.

The U.S. stock market's robust return we mentioned is all the more surprising when we remember that at the start of the year, the market was predicting as many as six separate 25 basis point reductions to the Fed funds rate in 2024. These optimistic forecasts have been pared back significantly over the course of the year.

And after last week's well-received CPI report, the market is now pricing in the first cut in September, perhaps another by year-end, and a third 25 basis point reduction in the first quarter of 2025. Softening economic data also provides cover to the Fed to initiate an interest rate cut before the November elections, a timing that might otherwise it would prefer to avoid to prevent politicization of its actions. Importantly, as we move forward and interest rates start to decline, we expect investors will adopt a show-me approach to growth in corporate earnings and revenues and margins, to justify current share price valuations that have been bid up in the expectation of monetary easing.

Current expectations for the second quarter results call for an average 4.5% increase in revenues, and an average increase in earnings of 9.6%, accompanied with an expansion in margins. As we've seen before, any disappointment in these expectations will likely prompt

a harsh reaction. Consumer spending is by far the biggest driver of the economy.

And according to the U.S. Bureau of Economic Analysis, in the first quarter, personal consumption expenditures represented nearly 68% of the nation's gross domestic product. The U.S. Consumer Price Index published by the U.S. Department of Labor includes a range of goods and services that track domestic inflationary trends.

Strategas' Common Man CPI does the same, but it weights daily necessities that people must buy, like food, energy, shelter, clothing, utilities, as opposed to things that they might like to buy, like television sets. As we can see here, over the last three years, the common man's real purchasing power has been meaningfully eroded by inflation.

And it helps to explain why many Americans are feeling dispirited and not crediting the current administration with stronger approval ratings on the economy. Here we can see that the extraordinary financial support that most U.S. consumers receive from the government, as it sought to backstop and subsidize the economy during the COVID years, has been spent.

And importantly, the savings rate has turned negative so that American spending power and now tied to their income and the labor market. This data point helps to explain why consumer-related stocks have been underperforming in recent months. As a result of these reduced savings, U.S. household debt has increased to elevated levels.

And more Americans are now falling behind on their credit card payments and auto loans, according to data from the Federal Reserve Bank of New York. Also, a recent Census Bureau survey reported that a third of households found it somewhat or very difficult to pay for usual household expenses in the prior week.

At the same time, in addition to concerns surrounding the increases in residential rental rates, U.S. home sales are still in the doldrums because of affordability issues and the high cost of mortgages. As I'm sure you know, the current 30-year fixed rate is still around the 7% mark, a multiple of the prevailing rates before interest rates rose.

And homeowners are naturally reluctant to move if they enjoy a cheap mortgage. Single-unit housing permits fell by 2.3% in June. That now represents the fifth straight monthly decline according to Strategas. Although gradual relief to the housing market should be forthcoming as U.S. interest rates start to decline.

Representing another crack in the U.S. economy's strength is the rising corporate insolvencies. This slide illustrates that the economic stresses we've discussed are not restricted just to U.S. consumers, as the lagged effects of higher long-term interest rates are showing up in corporate bankruptcies that, according to one analyst, are rising at the fastest pace since the first pandemic year in 2020.

It also reminds us of the importance of owning companies that are financially healthy and that are cash flow positive. More broadly, global economic sentiment has become more negative, as this slide from McKinsey's most recent economics conditions survey illustrates. Although the respondents, who are executives of globally based businesses, are still generally positive.

They have become notably more bearish in their outlooks for the three months to June, with 53% predicting a high likelihood of a near-term global recession. 45% of the respondents also cited rising uncertainty to geopolitical conflicts, economic turbulence and falling consumer sentiment. Political transitions, concerns over trade, regulatory policy and inflation were also mentioned.

The McKinsey study also highlighted that respondents in several economies expect a rise in international unemployment, with 41% predicting that their country's employment rates will increase in the next six months. According to the McKinsey analysis, this marks the largest share of respondents to cite unemployment risk since July of 2021.

The notable exception was in India that is enjoying a period of growth, as the country's a prime beneficiary of supply chain migration from China. Turning back to the U.S. stock market, we've referenced this slide in previous calls and do so again, as it graphically highlights how the S&P 500 Index returns have been so concentrated in just a few of the largest stocks.

It is remarkable to note that today the top 10 stocks now represent 37.5% of the index, a level significantly higher

than the concentration evident before the bursting of the dot-com bubble at the turn of the century. In last quarter's call, we commented that the Magnificent Seven AI-leading stocks had shrunk to the so-called Fab Four of Nvidia, Microsoft, Meta and Amazon, and that this trend indicated that market leadership had become even more narrow during the first quarter. According to Callan's Capital Markets Research Group, concentration risk is now the No. 1 concern for institutional clients right now. And at Jensen, we believe that concentration in a narrow pool of companies remains inherently risky.

Due to its lopsided composition, the U.S. market is now potentially vulnerable to a reevaluation of the future prospects of little more than half a dozen companies. It's unclear if the selling of the AI tech leaders that Jannis mentioned since last week, represents short-term profit taking, or the start of a more meaningful rotation that favors the broader market.

However, we are confident that the current momentum-driven bull market will end at some point. So we consider it prudent to counsel diversifying into investment options that offer some protection against the eventual unwinding of the current status. We also noted in the first week of July, Nvidia, the AI poster child that has helped to drive the current bull market, received its first broker downgrade based on its elevated valuation.

Here's another reflection on the distorting effects of the current concentration within the S&P 500 Index. Here we can see that if they were to have their own index sector, the market cap of the Magnificent Seven that comprises Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla, would represent 33% of the index.

But the contribution of their income to the index is only 23.3%, a 30% discount to their market valuations. Before we leave the topic of the nature of today's market, we thought it helpful to share this slide that is consistent with high-quality stocks being out of favor. Overall, shares of earning companies have underperformed those of non-earners since the start of the pandemic, largely because of 2023's results.

This disconnect is not terribly meaningful in the short term, as the market is forward-looking and constantly discounting the future. But in the long term, earnings and price growth tend to be highly correlated, which suggests this trend is unlikely to persist indefinitely. Since Jensen's founding in 1988, we've witnessed similar periods of relative performance shortfalls during instances where the market has been concentrated in the late 1990s and mid 2000s.

Following both of these periods, bear markets ensued and the Quality Growth Strategy substantially outperformed the benchmark. We are reminded of Mark Twain's famous comment that was, "History does not repeat itself, but it often rhymes." While details, circumstances and names change, similar events will essentially recycle. We're getting the sense that we may be in a similar rhyming period now.

As a result of the significant increase in government spending prior to, during and after the pandemic, U.S. debt has increased in absolute terms. But more importantly, with higher interest rates, the cost to service this debt has skyrocketed, so that now over 17% of tax revenues are required to service interest payments, a level last seen in the 1990s.

This implies that regardless of who wins the presidential election or controls Congress next year, the capital markets will at some point require a reduction in spending and/or an increase in taxes, to adjust the current trend to a more sustainable level. We only need to look at the 49-day tenure of former British Prime Minister Liz Truss's government in 2022, to see what happens when the bond market loses faith in political leadership.

The U.S. hasn't seen meaningful evidence of the so-called bond vigilantes for many years, but they could resurface if the U.S. government does not address the current, unsustainable costs of servicing our national debt. By the way, the same theme also applies to state and local governments that indicates that not only will the politics of debt become allowed a part of the political conversation, but also that sovereign and state governments worldwide are no longer in the position to deliver the subsidies to their voters, as and when the next crisis arises. As a further testimonial to the unsustainable position of our national finances, here we can see that the domestic debt servicing cost has risen to the point that nearly equals our annual $820 billion-plus national defense budget.

Factor in Social Security and Medicare entitlement costs, it seems clear that our government will need to restore order to our national accounts, if we are to remain the world's leading economic and military power positioned to maintain world order in the face of the geopolitical challenges we discussed earlier. As we all know, investing involves risks, and we have touched on many of these this morning.

Although these risks change and evolve over a certain time, we take great comfort in the compelling characteristics of the companies that comprise the Jensen Quality Growth Strategy. Some of these characteristics are detailed on this slide and illustrate why we believe it is important to know what you own. And to favor highly profitable companies with durable, competitive advantages, pricing power, and consistent revenue and earnings.

In our opinion, we believe these high-quality attributes can provide resiliency, buy a financial flexibility, and all help to mitigate the inevitable economic challenges we face now and over the long term. While our businesses are not immune from the factors affecting global economy and markets, we're reassured by their compelling attributes, and permit me just to highlight a couple here.

As of June 30, the average return on equity for the fund's companies was 32.7%, more than twice our minimum 15% ROE requirements. These businesses really are very profitable. And while our portfolio companies' earnings per share growth is currently forecast to be lower than the benchmarks' AI-influenced expectations at 22.2%, the variability or volatility of our company's earnings is less than half of that of the markets.

While our DCF models are proprietary and we do not share these publicly, as we can see from our quality companies' price to earnings multiples, they are not overextended, and in fact are trading at a discount to the usual premiums investors typically pay for them. It's not often that we see our companies' share prices look so attractively priced compared to the broader market.

Of course, in the shorter term, shareholders are also rewarded by growing dividends and share buybacks. Importantly, the portfolio's company debt coverages remain significantly higher than those that comprise the S&P 500. We are also pleased by the portfolio's attractive 10-year return performance profile. The fund participates in appreciating markets, but importantly, captured only 87% of the market's downside protection.

So we've mentioned long-term investing during the course of this call, and certainly for active stock pickers like Jensen, the recent highly concentrated market returns have represented a challenging background. Although we've worked through similar periods in the past, frankly, it's also been frustrating as company specific and quality fundamentals have generally played second fiddle to a momentum-driven market, whose returns have been reliant on just a handful of companies. However, a major differentiator and we believe a competitive advantage for the fund is its focused and conviction-based strategy. And we believe it's important to judge the unique characteristics and performance over the long term.

For us, we would certainly prefer to be judged over an entire economic stock market cycle that we believe more closely aligns with our own and your clients' investment horizons. Here, we summarize the fund's performance over the last two complete stock market cycles that we defined as one market peak to another.

Rather than going into the details at this point, I would just comment that overall, we are very pleased not only with the fund's outperformance compared to the S&P 500 over these cycles, but also, importantly, the upside capture we recognize tends to be lower than the market in a bull market. But the downside capture importantly over these cycles is considerably less.

So over the entire economic and stock market cycle, the fund has been able to provide our shareholders with superior investment returns, and as you can see, much less volatility. So as we look forward, the risk-on character of a secular growth market with AI and tech companies underwriting the broader market's returns has not been without merit, as Jannis alluded to.

But also as we consider the outlook for the U.S. and more globally, we are cognizant that many commentators are concerned by the perceived negative disconnect between the market's strong, positive return in the second quarter and year to date, and perhaps a more fragile state of the underlying economy.

Given their competitive strengths, wide economic moats, high profitability, robust balance sheets and a strong cash flow generation, we believe the quality growth companies owned by the fund are much better positioned to chart their own paths compared to some of their competitors. And that they should continue to deliver the results that longer-term shareholders have enjoyed.

Clearly, not all businesses enjoy the same high-quality features that characterize the fund, and we would urge caution for investors with exposure to lower-quality, more-expensive businesses, who we suspect will be in a much more precarious position as and when volatility returns to this market. So in closing, thank you for joining us today and for your support of the Jensen Quality Growth Fund that we never take for granted.

We remain confident that the fund remains well positioned to navigate the challenges of today and tomorrow, and we work hard to deliver those results that you expect from us every day. With that, we'll move to questions and answers.

The Jensen Quality Growth Fund's investment objective, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectus for each fund contain this and other important information about the investment company, and they may be obtained by visiting www.jenseninvestment.com or by calling 800.992.4144. Read it carefully before investing.

The Fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual stock volatility than a diversified fund.

Mutual fund investing involves risk. Principal loss is possible. The prices of growth stocks may be sensitive to changes in current or expected earnings, may experience larger price swings and may be out of favor with investors at different periods of time.

Visit www.jenseninvestment.com to view the Jensen Quality Growth Fund's current performance, including the 5-year upside/downside capture. Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. All returns include the reinvestment of dividends and capital gains.

The Jensen Quality Growth Fund is distributed by Quasar Distributors, LLC.

JENSEN®
INVESTMENT MANAGEMENT

5500 Meadows Road, Suite 200
Lake Oswego, OR 97035
800.221.4384

jenseninvestment.com