

Fourth Quarter 2023 (January 2, 2024)

In 2023 the equity markets rebounded from the steep declines of the prior year. Businesses are still trying to navigate the post pandemic world, and the ebb and flow of global consumer spending. Innovation, the backbone of our ever-progressing standard of living, took a leap forward in 2022 with the introduction of a free application of Artificial Intelligence (AI). That rang the bell, notifying businesses they need to invest in AI to stay ahead, or at a minimum keep up with competition by improving their offerings and increasing worker productivity. Many are struggling to report business results that exceed recent elevated levels achieved during the pandemic. In our view this is important to support higher stock prices and we explore this subject in more detail below. One of our most important mentors, Charlie Munger, passed away and we reflect on his overall contributions to the investing community, as well as for us personally.

Reaching for Growth Post Pandemic

Across our portfolios we put the **SEM-Disciplined Investment System (SEM-DIS)** to work in the same way we have in our first 25 years, favoring the ownership of companies that have strong balance sheets, earn high returns on capital, and generate excess free cash flow. In our three equity portfolios any new business that entered, and those that we replaced, reflected an emphasis on a clear path to growth. While a general rebound in stock prices occurred in 2023, returns this year may be more supportive of those that excel past their highest post pandemic business results.

To illustrate we have chosen a collection of companies, grouped by industry that we **do not** own, but that did well due to pandemic spending. Now, however, their 2024 outlook for growth is cloudy, and understandably they are struggling to surpass their prior peaks and grow earnings. Remember stocking up on toilet paper or cleaning supplies during Covid? That is what led Kimberly-Clark and Clorox to post record results in 2020. Pfizer launched its Covid vaccine late that year and Abbott's lab testing business grew significantly. Target benefited from stimulus checks and more consumer spending on groceries and home goods. Texas Instruments, Best Buy and Williams & Sonoma supplied the electronics, computers, TVs, and furnishings for a remote work lifestyle, while FedEx and UPS delivered those goods. Later in the pandemic recreation became popular with Polaris and Thor selling more boats, motorcycles, and RVs. NVR, a residential homebuilder, also did well.



<u>Company</u>	<u>2020</u> <u>EPS</u>	<u>2021</u> <u>EPS</u>	<u>2022</u> <u>EPS</u>	<u>2023e</u> <u>EPS</u>	<u>2024e</u> <u>EPS</u>	<u>2024 % Decline</u> <u>From Peak Year</u>
Clorox	\$7.36	\$7.25	\$4.10	\$5.09	\$4.62	(37%)
Kimberly Clark	\$7.74	\$6.18	\$5.63	\$6.59	\$7.08	(9%)
Pfizer	\$1.63	\$3.85	\$6.58	\$1.55	\$2.22	(66%)
Abbott	\$3.65	\$5.21	\$5.34	\$4.44	\$4.63	(13%)
FedEx	\$9.50	\$18.17	\$20.61	\$14.96	\$17.69	(14%)
UPS	\$8.23	\$12.13	\$12.94	\$8.81	\$9.67	(25%)
Texas Instruments	\$5.97	\$8.26	\$9.40	\$7.04	\$6.59	(30%)
Best Buy	\$7.91	\$10.01	\$7.08	\$6.16	\$6.10	(39%)
Target Corp.	\$8.64	\$13.56	\$5.98	\$8.31	\$9.08	(33%)
Williams & Sonoma	\$8.61	\$14.75	\$16.32	\$14.55	\$14.70	(10%)
Polaris	\$7.71	\$9.13	\$10.40	\$9.70	\$9.12	(12%)
Thor Industries	\$5.31	\$11.85	\$20.59	\$6.95	\$6.70	(67%)
NVR	\$230.11	\$320.48	\$491.82	\$463.38	\$417.87	(15%)

Source: Refinitiv Eikon

In contrast, we highlight a sample of companies from our three portfolios, all of which we owned prior to the pandemic. Their earnings grew the last several years and their 2024 outlook is solid.

<u>SEM Companies</u>	<u>2020</u> <u>EPS</u>	<u>2021</u> <u>EPS</u>	<u>2022</u> <u>EPS</u>	<u>2023e</u> <u>EPS</u>	<u>2024e</u> <u>EPS</u>	<u>2024 % Growth</u> <u>From Peak Year</u>
SEM Select Growth						
Adobe	\$10.10	\$12.48	\$13.71	\$16.07	\$17.95	12%
Intuit	\$7.86	\$9.74	\$11.85	\$14.40	\$16.37	14%
Mastercard	\$6.43	\$8.40	\$10.65	\$12.17	\$14.24	17%
SEM Dividend Growth						
Microsoft	\$5.76	\$8.05	\$9.21	\$9.81	\$11.24	15%
Sherwin Williams	\$8.19	\$8.15	\$8.79	\$10.30	\$11.25	9%
Stryker	\$7.43	\$9.09	\$9.34	\$10.41	\$11.55	11%
SEM Small to Mid-Cap Growth						
Copart	\$0.64	\$0.93	\$1.12	\$1.26	\$1.46	16%
Edwards Life Sciences	\$1.86	\$2.22	\$2.48	\$2.51	\$2.77	10%
Fair Isaac Corp.	\$7.90	\$13.40	\$14.18	\$19.71	\$23.63	20%

Source: Refinitiv Eikon

As we have noted in past letters, we believe stock prices eventually follow the profitability and intrinsic value growth of a company over long periods of time and as owners we should benefit from that growth.

Perspective from Charlie Munger, an Epic Contributor to Intelligent Investing

Charlie Munger, philanthropist, Vice Chair of **Berkshire Hathaway**, and Warren Buffett's closet partner, passed away in November five weeks before his 100th birthday. He was a highly intelligent man who graduated from Harvard Law School without ever attaining an undergraduate degree and was also known for his generosity and simple lifestyle, having lived in the same house the last 70 years despite being a billionaire (the same is true for Warren Buffett).

Munger joined Berkshire Hathaway in the late 1970s and has been credited with steering Buffett's investment philosophy towards buying growth companies at reasonable prices and holding them for long time periods (hopefully forever). Prior to that, Buffett had followed Benjamin Graham's advice and purchased companies that were cheap, typically selling them as they got closer to fair value. Munger's second major contribution to Berkshire was investing the float from the premiums of their insurance operations, like GEICO, in these above average businesses, according to a 1996 cover story by *Forbes Magazine* called "*The Not-So-Silent Partner.*" These contributions, and so much more, through the joint efforts of Buffett and Munger have created tremendous value for Berkshire Hathaway and its shareholders, which we benefited from as part of the **Select Growth** portfolio.

Known for his valuable insights and quick wit, we share a few of our favorite Munger quotes that have helped guide us over the last 26 years:

"An idiot, or a computer, can diversify a portfolio. But the whole trick (...) is to have a few times when you know something is better than average and invest only where you have that extra knowledge. If that gets you a few opportunities, that's enough."

"Invest in a business any fool can run, because someday a fool will. If it won't stand a little mismanagement, it's not much of a business."

"A lot of people with high IQs are terrible investors because they've got terrible temperaments. And that is why we say that having a certain kind of temperament is more important than brains. You need to keep raw irrational emotion under control. You need patience and discipline and an ability to take losses and adversity without going crazy. You need an ability to not be driven crazy by extreme success."

"We recognized early on that very smart people do very dumb things, and we wanted to know why and who, so that we could avoid them."

"People calculate too much and think too little."

"I try to get rid of people who always confidently answer questions about which they don't have any real knowledge."

"Acknowledging what you don't know is the dawning of wisdom."

"The big money is not in the buying and the selling, but in the waiting."

"We have three baskets for investing: yes, no, and too tough to understand."

"You'll do better if you have passion for something in which you have aptitude. If Warren Buffett had gone into ballet, no one would have heard of him."

Our all-time favorite Charlie Munger presentation occurred at the University of Southern California entitled "A Lesson on Elementary, Worldly Wisdom as It Relates to Investment Management & Business." He laid it all out at a perfect time for **SEM** to learn from, just as we were beginning the second year of our company. You can search Google for it or contact us and we will send it to you!

Closing Thoughts

Munger’s sage advice and intellect are a guiding light for our mission at **SEM** as we grow and preserve our clients’ capital, including our own families and fellow colleagues, investing alongside our clients by owning the same portfolio holdings.

Entering our 27th year of business, we will work diligently and passionately to own above average businesses at a fair price, while avoiding what we do not understand, and investing prudently, with a long-term time horizon. Happy New Year and best wishes for a more peaceful 2024 at home and around the world!

Sincerely,

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CIO

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Investment advisory services are offered through Suncoast Equity Management, LLC, a Securities and Exchange Commission Registered Investment Advisor.