



First Quarter 2024 (April 1, 2024)

In the first quarter of 2024 the equity markets built on the strong gains from last year, with the S&P 500 posting slightly higher results at +10.6% versus the **SEM – Select Growth** portfolio at +9.0% net of fees, after SEM outperformed in 2023. We discuss the purchase of **Eaton Corporation** and increase of **Salesforce**, as well as the sale of **Tractor Supply** and trim of **Apple**. With copious amounts of articles being written about generative AI and how specific companies will benefit, we discuss how we try to filter out the noise and focus on relevant data points of our portfolio companies, **Nvidia** and **Adobe**.

Portfolio Activity

We purchased a small position of **Eaton Corporation (ETN)** during the quarter, a global manufacturer of mission-critical, highly engineered power management products for data centers, industrial, vehicle, construction, commercial and aerospace companies. Products include hydraulic motors and generators, fuel systems, backup power, energy storage, filtration solutions and many others. ETN is benefiting from the “electric super cycle” of energy transition from fossil-based products to renewables, electrification of cars and trucks (EVs) and the digitization of industries such as healthcare and finance. It is also benefiting from the reindustrialization of North America and Europe as governments reinvest in domestic manufacturing facilities. For example, the US Infrastructure and Inflation Reduction Act allocates \$450 billion to grid modernization, climate, and energy programs and the €240 billion EU Recovery Plan allocates funds to create a “greener, more digital and more resilient Europe.” Eaton posted broad-based growth last year, but its largest segment, Electrical Americas, was especially strong with sales +19% and profit margins increasing to 27% from 23%. With backlog +23%, management increased their 2024 target for sales to grow 10-12% and expects adjusted earnings to grow in the mid-teens.

After initiating a position last quarter, we increased **Salesforce (CRM)** to 4% following its year-end report. As a refresher, CRM is a cloud-based company that allows customers to manage and share information about revenues, customer relationships, marketing, and data analytics.



More than 90% of its sales are from subscription services like Sales Cloud, Service Cloud, Marketing and eCommerce Cloud, which generate recurring revenue and allow management to have visibility into upcoming quarters. CRM posted sales +11% as well as strong margins and cash flow for its fiscal year 2024 ending January and expects subscription revenues to be +10% again this year with earnings +18-19%.

We sold our small position in **Tractor Supply (TSCO)** and used the proceeds to purchase ETN which currently has better business momentum. These decisions are always relative for us and we continue to own TSCO in our Dividend Growth portfolio since that portfolio already had a core position in ETN. Similarly, we trimmed our position in **Apple (AAPL)** to increase CRM which is growing sales and operating margins at a faster rate.

What's Signal and What's Noise?

By now most everyone has heard the narrative that generative AI and applications like ChatGPT are here and they're about to change everything from how drugs are discovered, to reducing financial fraud, to personalizing education, to optimizing agricultural crop yields. With powerful computing advantages, gen AI can perform tasks that would take months or even years and complete them in a matter of hours or days. As research analysts it's important that we try to distinguish between the signal and the noise surrounding generative AI and specifically as it relates to our portfolio holding **Nvidia (NVDA)**. Our **SEM-Disciplined Investment System (SEM-DIS)** and decades of studying great investors like Warren Buffett helps us stay focused on a company's competitive advantages (moat), capital allocation, financial strength and intrinsic value growth. These are all signals and we used these metrics to guide our purchase of NVDA last August. In March during the GPU Technology Conference the company announced its transformative Blackwell platform of AI chips which contains 208 *billion* transistors and they plan to start selling in April. The new B100 chips are much more powerful than the current H100 family of chips, while at the same time using significantly less energy. The Blackwell chips excel at inferencing (when AI uses massive amounts of data and training to draw a conclusion) and 40% of NVDA's AI revenues are from chips doing inferencing work. This disclosure surprised most analysts on the February earnings call since they thought cloud computing competitors like Amazon and Google were using their own chips for inferencing. Data points like this speak to NVDA's first mover advantage and ecosystem of industry leading hardware and software.



Another signal is that working for NVDA has become a “dream job” and is drawing tech talent from other companies much like Facebook did in 2014, according to an article in *The Wall Street Journal* written by Katherine Bindley, Lindsay Ellis and Isabelle Bousquette. Access to the industry’s top talent is important because it allows NVDA to keep strengthening its economic moat.

In contrast to the signals noted above is the noise of economic forecasts related to gen AI, like productivity gains will add \$7 trillion to global GDP in the next 10 years (Goldman Sachs) or that it will affect 40% of jobs around the world (International Monetary Fund). Investment sentiment is also noise, like the pageantry of the GPU Tech Conference hyped as the “Woodstock of AI” with 11,000 attendees. Much like Buffett, we consider short term volatility in stock prices as noise and a normal part of investing. During our ownership, investors’ infatuation with NVDA and other AI companies could ebb and flow and stock prices will be volatile, although we can’t predict when or how often. As always, we will be watching the fundamentals like product launches, market share, margins and cash flow. We understand that no one, not even a visionary like Nvidia CEO Jensen Huang, can accurately predict how fast accelerated computing will ramp across industries or how much productivity will be achieved. It’s just too early to know. But what we do know is that NVDA has an ecosystem of hardware and software, is an industry leader which currently has a first mover advantage and is posting very strong business momentum. We will continue to watch all these metrics closely.

Our long-term holding **Adobe (ADBE)** also expects to benefit from incorporating generative AI into its platforms for creative cloud, document cloud, marketing and eCommerce. It launched Firefly for beta testing a year ago and has generated more than 6.5 billion images, designs and text effects since then. ADBE expects to monetize some of these transformative tools like text to image, generative fill and text effect in the second half of its fiscal year ending November. CEO Shantanu Narayen believes gen AI will lead to an “explosion” of video content and increase demand as well as the total addressable market for ADBE’s creative and editing tools. In February OpenAI launched Sora, which has the ability to create video from a text prompt and is a direct competitor to ADBE for the initial phase of image creation. ADBE’s stock sold off on the news even though Narayen stated he believes Sora will actually lead to *more* demand for ADBE’s tools not less since once an image is created it requires editing and distribution, both of which ADBE excels in.



At this point we don't have enough information to determine if this data point is signal or noise since no revenue much less profit has been generated for this application. But we believe Narayan deserves the benefit of the doubt and will be watching ADBE's fundamentals in the quarters to come.

Outlook

As we look to earnings season this spring, the portfolio appears on track to grow sales and earnings double digits in 2024, which is above growth expectations for the S&P 500. Please don't hesitate to reach out with any questions or comments.

Sincerely,

Don

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CIO

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Suncoast Equity Management, LLC

Performance results versus the Standard & Poor’s 500 Index

<u>Time Period</u>	<u>SEM % Return*</u>	<u>S&P 500 % Return</u>	<u>SEM - Growth of \$1,000,000</u>	<u>S&P 500 – Growth of \$1,000,000</u>
1st Quarter 2024	+ 9.0%	+10.6%	\$ 1,090,300	\$ 1,105,600
One-Year	+31.3%	+29.9%	\$ 1,313,400	\$ 1,298,800
Three-Year	+10.7%	+11.5%	\$ 1,356,900	\$ 1,385,900
Five-Years	+15.4%	+ 15.0%	\$ 2,047,000	\$ 2,015,700
Ten-Years	+13.5%	+13.0%	\$ 3,555,600	\$ 3,382,600
<i>Inception (26 1/4 Years)</i>	<i>+10.3%</i>	<i>+ 8.6%</i>	<i>\$ 13,058,500</i>	<i>\$ 8,791,100</i>

* Composite results of all SEM Select Growth managed accounts, net of all fees.

Note: Performance for the three, five, ten, and since inception year periods represent the annual average rates of return



Performance Disclosure

Suncoast Equity Management, LLC (SEM) is an independent investment management firm established in 1997. Suncoast Equity Management is primarily an equity investment manager that invests in U.S.-based securities. SEM also invests in high-grade fixed income. The Select Growth composite includes all discretionary, fee-paying portfolios managed within this strategy. The creation and inception date of the Select Growth composite is 12/31/1997. As of 6/30/2020, the Suncoast Equity Management composite was renamed the Select Growth composite.

The Select Growth composite is an equity only composite employing the principles of Benjamin Graham & Warren Buffett. The discipline is a bottom-up fundamental approach and blends value and growth parameters. The portfolio consists of between 18-22 stocks.

Bundled fees include management consultant fees, custodial, trading, and advisor fees. Performance is calculated gross of all foreign withholding taxes. Additional information regarding policies for valuing investments, calculating performance, and preparing GIPS Reports, as well as a complete list and description of composites, is available upon request.

For the non-bundle fee accounts, the performance results presented are net of actual investment advisory fee and net of all transaction costs. For the bundle fee accounts, the performance results presented are net of actual investment advisory fee and net of all transaction costs and expenses. Investment advisory fees are described in Part II of Suncoast Equity Management, LLC's Form ADV. The management fee schedule is as follows: 1.00% fee on assets managed. The Firm does not assess performance-based fees.

It is impossible to invest directly in an index. The performance of an index does not reflect any transaction costs, management fees, or taxes. The indices used for comparison are as follows: The Standard and Poor's 500 Total Return Index is an unmanaged index with no expenses, which covers 500 industrial, utility, transportation, and financial companies in the U.S. markets. It is a capitalization-weighted index calculated on a total return basis with dividends reinvested.

Valuations and returns are computed and stated in U.S. Dollars. The Firm does not use leverage or derivatives to implement the intended strategies.

Beginning in June 2002, accounts that experience cash flows in excess of 10% of the account's market value are temporarily removed from the composite. These accounts are added back to the composite when they are considered fully invested. The minimum account value for inclusion in the composite is \$100,000. Additional information regarding the treatment of significant cash flows is available upon request.

Suncoast Equity Management adheres to the GIPS valuation hierarchy principles.

Past performance does not guarantee future results. Investment returns and principal value will fluctuate. Investments may be worth more or less than their original cost when sold. It should not be assumed that investment decisions we make in the future will be profitable. Current performance may be lower or higher than the performance data shown. Returns include the reinvestment of all income.

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