December 2023

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

– Charlie Munger

The above quotation from the late famed investor Mr. Munger lingers in our head as we reflect on his storied career given his recent passing, and on the performance of the Geneva Investment Strategy this year as investors eschewed small and mid-cap growth companies and crowded into 7 mega-cap stocks. More importantly, we view the Magnificent 7 Market Regime as providing an opportunity to acquire "splendid businesses selling at reasonable prices." (…with deference to Mr. Munger). The Geneva Investment Strategy offers exposure to small and mid-cap innovation companies growing multiples faster than GDP, with attractively high margins, an included call-option of strategic M&A and PE take-outs while trading at sharp discounts to prior periods. 2023 welcomed more data points confirming the decade-old investment process of identifying strategic assets (57 portfolio companies acquired by strategic or private equity since inception[1]). Our investment team believes the mega-cap FOMO market has set the stage for a heightened period of M&A, and/or a powerful mean reversion trade into small cap as investors take profits and position for lower rates.

Our fundamental research suggests that underlying business trends at our companies remain robust and that these businesses will continue to compound over the next few years. Eventually, the market will re-rate these companies – we suspect as rates begin to decline – and investors begin to unwind the Mag 7 trade.

As a thought experiment,[2] we performed a scenario analysis of the potential returns to small and mid-cap technology companies if investors took profits from the terrific gains they made in MSFT or NVDA this year and rotated partially into the smaller names as a reversion trade, or to position for falling rates. Our research team pulled data from Bloomberg to calculate the hypothetical return of small and midcap technology stocks if investors sold a percentage of their holdings in MSFT or NVDA, and transferred that dollar amount into the small and mid-cap names. The scenarios are eye-opening:

[1] *Not all acquisitions are profitable. The positions can be acquired at a price that is less than the price at which the Firm purchased its interests for its clients. The information is being shown to reflect the Firm's ability to select investments that are likely to be acquisition targets and not to reflect any positive investment experience. The holdings identified do not represent all of the securities purchased, sold, or recommended for Pier 88's clients. It should not be assumed that investments made in the future will be profitable or will equal the performance of the securities in this list. Additional information, including (i) the calculation methodology; and (ii) a list showing the contribution of each holding to the account's performance during the period will be provided upon request. Past performance is not indicative of future results.*

[2] *This performance record is hypothetical. Hypothetical performance results have many inherent limitations, some of which are described below. No representation is being made that any pool will or is likely to achieve a performance record similar to that shown. In fact, there are frequently sharp differences between a hypothetical performance record and the actual record subsequently achieved. One of the limitations of a hypothetical performance record is that decisions relating to the allocation of assets are made with the benefit of hindsight. Therefore, hypothetical performance records invariably show positive rates of return. Another inherent limitation on these results is that the allocation decisions reflected in the performance record were not made under actual market conditions and, therefore, cannot completely account for the impact of financial risk in actual trading. There are numerous other factors related to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in the preparation of hypothetical performance results and all of which can adversely affect actual trading results.*

% MSFT Rotate Into R2KGSW	Hypothetical Return for R2KGSW	% NVDA Rotate Into R2KGSemi	Hypothetical Return for R2KGSemi
10%	163%	10%	192%
20%	325%	20%	385%
30%	488%	30%	577%
40%	650%	40%	769%

Source: Pier 88 Research as of November 30, 2023.

The Law of Supply and Demand is on display in the aforementioned table as a small percentage of profit taking in the mega caps can drive outsized returns in the under-owned smaller companies. It is simple math; it is easier for a small number to double than a big number.

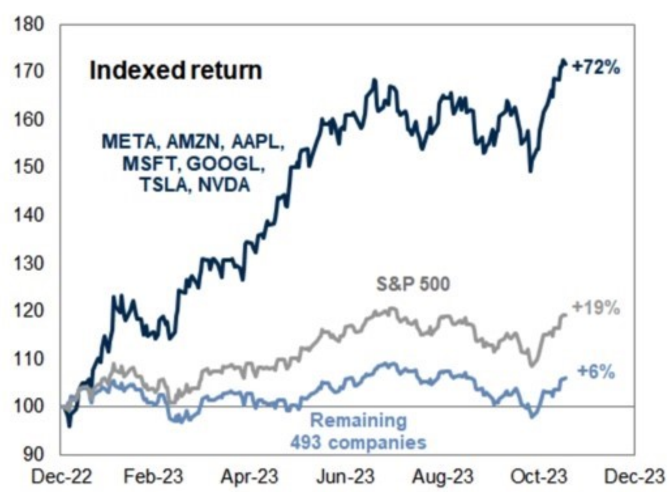
Further, we compared MSFT to all the software companies in the Russell 2000 Growth Index ("R2KGSW") and NVDA to all the semiconductor companies in the Russell 2000 Growth Index ("R2KGSEMI"). The combined market cap of the 82 software companies in R2KGSW represents a mere 6% of MSFT's current market cap, yet the smaller companies will grow revenue almost twice as fast this year. MSFT's current price-to-sales multiple is approximately 12.6X while the smaller companies have an average price-to-sales multiple of 4.8X. Similarly, the 28 semiconductor companies in R2KGSEMI have a combined market cap that represents approximately 5% of NVDA's current market cap. NVDA has a price-to-sales multiple of over 27X while the valuation of the R2KGSEMI is closer to 4X. We would never dis the technology franchises built by MSFT or NVDA; the latter is the first stock I recommended when I matriculated to the buyside. We do, however, view the stock prices of these companies as expensive relative to many of the companies in the Geneva portfolio and in the small and mid-cap universe.

Our investment team shares the mindset from Omaha when we look for "splendid businesses selling at reasonable prices." Our preferred valuation framework is to examine the market cap of the company relative to the company's current total addressable market ("TAM"). Our decades of experience investing in innovation sectors informs us that corporate development teams at larger industry players often leverage this framework when evaluating strategic opportunities. The theory is that a company with a broader channel and sales reach can capture more of the addressable market. Below is an analysis of the technology companies in the Geneva portfolio along with secular trends to which each company is exposed. We would argue that many of our companies are levered to the same secular trends that are currently benefiting the Mag 7, yet most of these franchises are not yet being rewarded by the market with average valuation representing only 34% of the TAM.

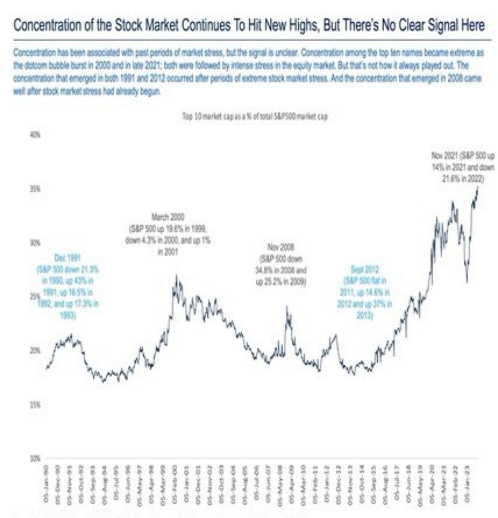
Portfolio Company	Mkt Cap/TAM	Secular Growth Trends
Semiconductor Co. A	18%	Edge IOT, Renewables, EV, Smart Lightbulps, Artifical Intelligenance/Machine Learning Computing
Software Co. A	17%	Low code software developent, AI powered software development
Semiconductor Co. B	26%	Low power computer acceleration, edge computing, AI, Computer Vision, Smart Home, Next gen auto
Cyber Co. A	39%	Cloud and mobile security
Semiconductor Co. C	10%	IOT
Cyber Co. B	32%	Cloud Security , AI-Lead innoation in Cyber Security
Software Co. B	30%	AI-Powered Smart Customer Relationship Management Software
Computer Systems Co. A	16%	Hybrid Cloud Infrastructure
Semi Equipment Co. D	52%	Material Sciences & Advanced Manufacturing for Semicondcutors and Life Sciences
Software Co. C	10%	Cloud-based Revenue Optimization Solutions for Life Sciences & High Tech, Data Analytics
Software Co. D	3%	Data Science & Analytics, Generative AI, Computer Vision, Natural Language, Machine Learning
Cloud Computing Co. A	17%	Integrated Global Cloud Computing & Security Platform
Cyber Co. C	15%	Identity Management
Software Co. E	113%	SaaS & Low Code sotfware focused on State, Local, and Federal Government
E-Commerce Software Co. A	3%	Creative Tools & AI Software Engines to create, develop, and manage websites & online commerce
Software Co. F	4%	AI-powered, real time price optimization and revenue management software
Software Co. G	60%	Observability, Security & Optimization Software for Cloud Computing Applications
Semiconductor Co. E	124%	Power management semicondcutors for next gen computing, electrification of autos, etc.
Cyber Co. D	16%	Cyber & Identity Security
Semiconductor Co. F	69%	Factory Automation, EV Charging, Advanced Safety, Energy Infrastructure
Average Valuation to TAM	**34%**	

Source: Pier 88 Research November 30, 2023

This year, fears of stickier inflation, higher interest rates, and geopolitical risks caused investors to sell perceived riskier assets and move into a few large companies like AAPL, MSFT and NVDA where strong business franchises and rock-solid balance sheets provided a safe haven from a banking system in crisis. Although AI Euphoria gets credit for massive moves in MSFT and NVDA, we submit the initial crowding was really a defensive trade, followed by performance chasing. Although investors had been hiding in mega-cap technology all year, few areas proved immune from the sell-off. All major equity indices declined in the quarter with small caps bearing the brunt. The following charts are illustrative.



Source: FactSet, Goldman Sachs Global Investment Research



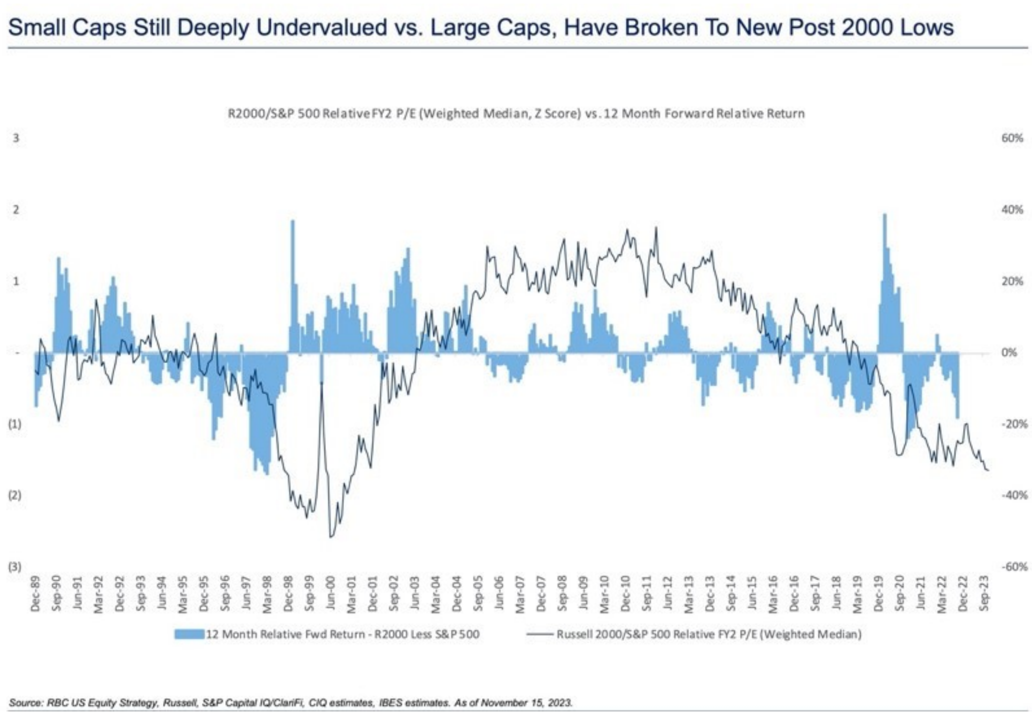
50 stocks that most frequently appear among the largest 10 holdings of hedge funds

Company	Ticker	Sub-sector	Equity cap ($ bn)	No. of funds with 10 to 200 positions owning stock 30-Sep-23	No. of funds with stock as top 10 holding 30-Sep-23	Average portfolio weight when stock ranks among top 10 holdings	% of equity cap owned by hedge funds 30-Sep-23	Total return YTD
Microsoft Corp.	MSFT	Systems Software	$2,751	154	111	8 %	2 %	55 %
Amazon.com Inc.	AMZN	Broadline Retail	1,504	156	97	8	2	74
Meta Platforms Inc.	META	Interactive Media & Services	747	126	83	8	4	179
Alphabet Inc.	GOOGL	Interactive Media & Services	1,579	106	51	6	2	51
NVIDIA Corp.	NVDA	Semiconductors	1,227	88	47	9	2	240
Uber Technologies	UBER	Passenger Ground Transportation	110	74	40	8	7	118
Apple Inc.	AAPL	Technology Hardware Storage & Peripherals	2,930	61	36	7	1	45
Seagen Inc.	SGEN	Biotechnology	40	37	27	10	42	66
Visa Inc.	V	Transaction & Payment Processing Services	397	64	25	7	3	20
Advanced Micro Devices	AMD	Semiconductors	194	53	24	6	3	85

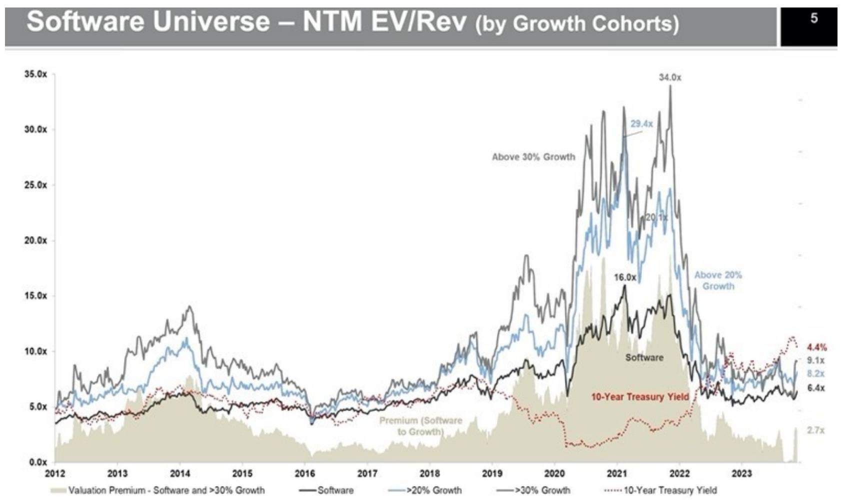
Source: FactSet, Goldman Sachs November 2023

It is fairly obvious that investors have been largely positioned one way this year, and we would argue it presents real risk. One cannot predict when this trade will unwind but it seems that the prospects of lower interest rates will be a likely catalyst.

Similar to last year, the broader market has been myopically focused on the direction of the U.S. 10-Year Treasury. The algorithm is simple: interest rates up, equities down. Areas perceived to be more at risk from prolonged higher rates, like small-cap growth stocks, experienced outsized moves.



Although we appreciate the theoretical risk higher rates may pose for smaller companies that are poorly positioned, carry higher debt loads, lack profits or have low margins, the punishment software stocks have endured (other than MSFT) seems overdone in our view for several reasons. Many software companies are levered to long-term secular trends, generate high gross margins and cash flow, have recurring revenue models, and remain attractive acquisition candidates to larger industry players. The average company in the Geneva strategy shares this attractive profile with revenue growth over the last 3 years of +24%, gross margins over 60%, and a healthy cash position to operate and grow for years. That said, stock prices have witnessed sharp multiple contraction with the average stock being down over 42% from 5-year highs. This inverse correlation to interest rates pattern is similarly depicted in the graphic below for software.



Source: Keybanc November 2023 for Software Multiples & Bloomberg for Sector Performance 10/23

The Pier 88 Investment team are not market timers, day traders, momentum chasers, nor avowed contrarians. We are business analysts, and fundamental investors, and aspire to be thoughtful risk-takers. We humbly submit buying secular growth companies with M&A and PE upside when others have been focused elsewhere is akin to Mr. Munger looking to pay a reasonable price for a splendid business. Staying invested in small and mid-cap innovation companies during the year of the Magnificent 7 Regime, often felt like listening to Tom Petty's "The Waiting" on auto replay for months as investors continued to pile into mega cap. We believe our investment discipline will be rewarded, and think like the late Mr. Munger, that "The big money is not in buying or selling, but in the waiting."

We are grateful for our clients and sincerely believe that being a steward of assets for others is an honor and privilege. Have a safe and joyful holiday with your friends and families.

Thank you for your consideration.

Respectfully,

Frank Timons

CEO

Pier 88 Investment Partners

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