WATERFRONT | BALANCED

2Q 2024 COMMENTARY

WATERFRONT | ASSET MANAGEMENT

Executive Summary

The equity market continued its advance in the second quarter with the S&P 500 hitting all-time highs in June. As economic growth has slowed, the market's advance has been led by fewer stocks with best-in-class growth characteristics to a point where concentration and crowding are at multi-decade extremes. Encouragingly, inflation has slowed, allowing the Federal Reserve to consider easing monetary policy in response to slowing growth and a gradually cooling labor market. Short-term interest rate cuts would improve the outlook for economic and earnings growth, which should help to broaden the market's advance. For the quarter, stocks posted strong returns while bonds were largely flat. The S&P 500 Index rose 4.3% in the second quarter and the Bloomberg U.S. Agg Gov't/Credit Index was essentially unchanged. The Waterfront Balanced Composite declined 0.3%, lagging the blended benchmark which posted a 2.6% increase as well as peers in the Morningstar Moderate Allocation category.

The second quarter of 2024 was highlighted by strong performance for an unusually small number of stocks. Of the 11 sectors in the S&P 500, just three posted meaningfully positive returns for the quarter: Utilities (up 4.3%), Communication Services (up 9.7%) and Technology (up 13.1%). In fact, the S&P 500 Equal-weight Index declined in value by 2.6% during the quarter. These episodes of market concentration are infrequent and of indeterminate length. The 'Nifty Fifty' era of the late 1960's into the early 1970's and the 'Tech Bubble' of the late 1990's and early 2000's are two examples of concentrated market advances that continued for years. In each case, a compelling trend or narrative captured investors imagination with this iteration revolving around Artificial Intelligence and its potentially life-altering implications. While the 'AI' theme is compelling, history suggests it doesn't end well with the previous episodes' growth darlings posting dramatic declines as reality failed to match the hype. Your account has several 'winners' from this proud group though not enough of them to match the S&P 500 return for the quarter. I am carefully weighing the risk/reward balance for each of these names and will exit them when the scales tip too far toward risk. I am also busy combing through the mass of stocks left behind during this rally as investors crowd into the names that are working. This growing list of laggards is rich with investment opportunities, some of which we took advantage of during the last several months. While the seductive 'siren song' of AI lures investment dollars toward a shrinking number of stocks, I am committed to focusing our investment dollars in reasonably priced, profitable businesses that can survive the inevitable 'shipwreck' and thrive in the years to come.

	Q2 2024 Total Return
Waterfront Balanced Composite (net)	**<0.3%>**
60% S&P 500 / 40% BBG U.S. Agg Gov't/Credit (benchmark)	**2.6%**
Morningstar Moderate Allocation category (median return)	**1.2%**
S&P 500 Index	**4.3%**
Bloomberg U.S. Agg Gov't/Credit Index	**0.0%**

The Waterfront Balanced strategy declined 0.3% in the second quarter, underperforming the funds benchmark (blended benchmark consisting of 60% S&P 500 & 40% Bloomberg U.S. Aggregate Govt/Credit) as well as peers in the Morningstar Moderate Allocation category. During the quarter and relative to the benchmark, performance was negatively impacted by an underweight of equity and less exposure to the

Technology sector than the S&P 500. At quarter-end, the strategy's allocation to equity was 55%; fixed income represented 44%; with the balance in cash.

The equity sleeve declined 1.0% during the quarter, underperforming the benchmark as an underweight of the Technology sector and poor stock selection in the Health Care sector hurt relative performance. Strong stock selection in the Communication Services sector was helpful to relative performance but insufficient.

The fixed income sleeve advanced 0.6% during the quarter, outperforming the benchmark. The Treasury curve inversion was relatively unchanged with the 2yr/10yr curve ending the quarter inverted by <35bps>. Investment Grade credit spreads were essentially unchanged at 96 bps, well below the 25yr average of ~157bps. Performance benefited from the duration and credit extension that took place in 2023.

The quarter's top contributors to performance were concentrated in the Technology and Communication Services sectors. Alphabet, Microsoft, Apple and Amazon are secular growers with strong competitive moats and unique growth drivers in 2024. Microsoft, Alphabet and Amazon have durable growth in their Cloud segments and a burgeoning opportunity in AI across their product suites. At Apple, the expectation of an iPhone product refresh cycle in 2024 & 2025 is gaining momentum. For Amazon, reported financials are also benefiting from the growing profitability of its consumer-facing segments. Micron (no longer held) is seeing booming demand for its memory chips as corporations race to build out the datacenters necessary to enable artificial intelligence. After several profitable years of ownership, I exited Micron late in the quarter as the stock fully reflected my expectations for a surge in earnings. For the other four positions, the fundamental outlook is strong, supporting my continued conviction.

TOP CONTRIBUTORS	AVG. WEIGHT	RETURN	CONTRIB-UTION
Alphabet Inc. (GOOGL)	2.9%	20.8%	0.54%
Microsoft Corp. (MSFT)	4.5%	6.4%	0.28%
Micron Technology, Inc. (MU)	0.6%	30.2%	0.19%
Apple, Inc. (AAPL)	0.9%	23.0%	0.17%
Amazon.com, Inc. (AMZN)	2.0%	7.1%	0.14%

Zimmer Biomet, Bristol-Myers Squibb and Charles River Labs are struggling to convince investors they can sustainably grow revenues. The drivers of investor skepticism for each story are idiosyncratic but, in each case, has resulted in a valuation discount to its peers and its own history. For Zimmer Biomet I find the setup particularly compelling as new product introductions and growing procedure volumes are likely in my view to overwhelm a deeply entrenched bearish investor base. Bristol-Meyers Squibb and Charles River Labs were recent additions to the strategy. For Bristol-Meyers, a storied legacy of innovation and drug development is being discounted at a rarely seen earnings multiple in the Pharma industry. I anticipate a dramatic recovery in the stock as the company utilizes its balance sheet and prodigious cash flow to invest in product innovation to drive future growth. Charles River Labs is a beneficiary of a secular rise in testing, analysis and research that is battling through the tough comps resulting from unprecedented demand

TOP DETRACTORS	AVG. WEIGHT	RETURN	CONTRIB-UTION
Zimmer Biomet Holdings (ZBH)	1.2%	<17.6%>	<0.23%>
Bristol-Myers Squibb (BMY)	0.8%	<22.5%>	<0.19%>
Charles River Labs (CRL)	0.7%	<23.8%>	<0.17%>
Las Vegas Sands Corp. (LVS)	1.0%	<14.1%>	<0.15%>
Canadian Pacific Kansas City Railroad (CP)	1.2%	<10.6%>	<0.14%>

during the COVID-19 pandemic. As those comparisons are lapped and the secular growth trends endure, both earnings and the multiple of the equity are likely to rise in my view. Las Vegas Sands is experiencing a lull in its growth rate as it invests to renovate and expand its properties in Macau and Singapore. In addition, several Asian economies have been under pressure which has slowed the growth in visitation and spend at its properties. As the cyclical headwind eases over time, the preeminent properties in their respective locales are likely to experience best-in-class recoveries in my view. Finally, transportation stocks have been enduring an 18-month freight recession resulting from slowing demand as consumers prioritized spend on services and experiences; and as excess capacity in the trucking space negatively impacted rates for transportation broadly. I expect the Federal Reserve to cut interest rates later in 2024 which historically has resulted in improving economic growth over time. Canadian Pacific has the premier rail footprint spanning North America which should drive disproportionately strong growth and returns. For each of the equities, I continue to believe in the long-term growth and profitability of the franchise and expect patience to prove rewarding.

As I look forward, the inflation outlook is clearly improving. And yet, while I am encouraged by the consensus view that inflation rates will cool further in the months ahead, the underlying inflationary impulse is likely to prove more intransigent. Over the medium and longer term, de-globalization, geopolitical tensions and global demographic trends impacting labor availability and healthcare costs suggest that the inflation backdrop may have structurally changed. If that proves true, interest rate increases by global central banks, which have been extreme, are unlikely to be entirely reversed. And as mentioned in many prior missives, the impacts of tighter monetary policy occur with a lag and will likely drive a reset in consumer and corporate spending and investment in the months ahead. While the consensus anticipates a series of interest rate cuts in 2024 and 2025, the previously discussed structural drivers of inflation seem underappreciated which suggests there will likely be some disappointment. Finally, the equity market's fascination with a small group of stocks is creating a yawning performance and valuation gap versus the rest of the market. There are a growing number of fairly valued profitable companies, several of which I added to the strategy in the second quarter. Companies like 3M Corp, Nike, McDonald's, Qiagen and Charles River Labs are steady compounders with durable competitive advantages whose value will endure through an uncertain future and prove compelling once investors tire of chasing what's 'working' today.

My focus is unchanged. Across economic cycles and irrespective of market moods, I seek to maintain an emphasis on finding high quality, growing companies whose securities are trading at a reasonable valuation with visible catalysts to drive relative performance over the long term. This approach has served investors well over time, and my confidence in it has not waned.

Matt Hekman
Portfolio Manager