the ithaka group

Concentrated Growth Equity Managers

ITHAKA US GROWTH STRATEGY

FIRM OVERVIEW
- Founded in 2008
- Based in Bethesda, MD
- Concentrated growth investors
- 100% employee-owned

STRATEGY OVERVIEW
- Seeking high-quality, rapidly growing companies with duration
- Bottom-up, company focused
- A conviction-weighted approach
- Maximum of 35 large-cap holdings

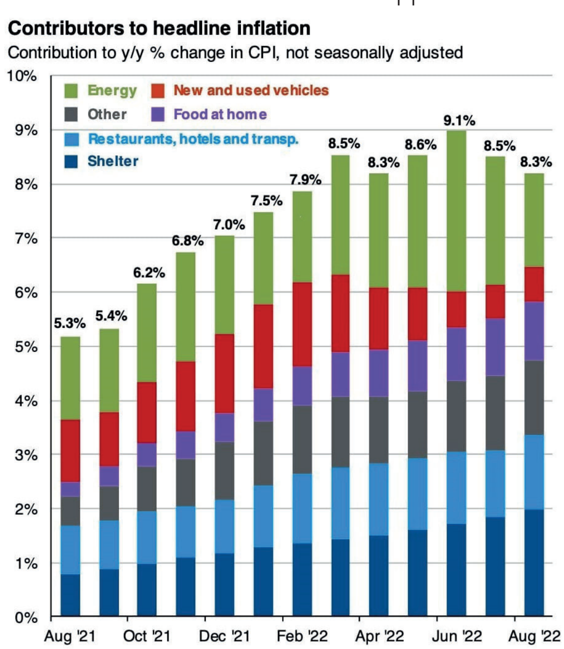
PORTFOLIO OVERVIEW
- Inception date: January 1, 2009
- Benchmark: Russell 1000 Growth ("R1000G")
- ~$910M AUM
- 6 investment professionals

OBJECTIVE
- Long-term growth of capital

PORTFOLIO MANAGERS
- William Johnson
- Scott O'Gorman, CFA

Market Review

The extreme market volatility, uncertainty and pricing pressure started by the Fed's hawkish pivot in November of 2021 continued into the third quarter. Asset markets have since experienced an epic bout of wealth destruction (~$58T across US equities and fixed income), best illustrated by the ~20% year-to-date drop in the traditional 60/40 portfolio, the steepest decline since the 2008 financial crisis, when it fell 21%. The decline in asset prices has been driven by a single factor: the Fed's decision to eradicate, at almost any cost, the highest rate of inflation we have seen in the past 40 years. This decision has led to the fastest rate-hiking cycle since the late '70's, with today's prime rate rising from 0% to over 3% in a mere 7 months. The rapid ascent in borrowing costs has left markets reeling, as the Fed's resolution seems to ignore some of the recent improvement in leading indicators the market is watching. For example, from their respective peaks, global shipping costs have dropped 40%, used vehicle prices have dropped 13%, the US energy index has dropped 10%, and the UN Food and Agriculture World Food Price Index has dropped ~15%.



Source: US Bureau of Labor Statistics

While several indicators, such as those mentioned above, appear to have passed their peak, headline inflation (see chart) and the Fed's preferred inflation indicator, Core PCE, remain stubbornly high. The Fed's sole focus on Core PCE continues to support its intention to raise rates until inflation has been subdued, which has resulted in extreme volatility in multiple different markets. For example, we have witnessed one-sided foreign currency markets, with the US dollar appreciating against most other currencies, bond market illiquidity, with the recent near collapse in price of the UK's gilt market, and struggling global real estate markets, particularly in China. Despite the pronounced level of turmoil in almost all asset classes, some major US economic indicators have stayed surprisingly resilient. Nominal wage growth of ~5% is roughly double the 2010-2020 period and September unemployment just matched the pre-pandemic low of 3.5%. With a strong labor market and stubbornly high prices, asset holders seem to have come to grips with the future pace of rate increases, with the Fed funds futures market now anticipating a 4.50% to 4.75% rate window in Feb 2023 (with a ~60% probability), which happens to meet the guidance from the Fed's September dot plot. As has been the case for 10 months now, pundits continue to debate whether the Fed's actions have already sent the US economy into a recession, or if not, when one is likely to begin. Correspondingly, there has been less and less debate that orchestrating a soft landing is becoming a taller and taller task.

3Q22 Performance

PERFORMANCE (%)	3Q22	1 YR	3 YR	5 YR	ITD[1]
Ithaka US Growth Strategy (Gross)	(7.5)	(40.4)	4.1	10.0	14.6
Ithaka US Growth Strategy (Net)	(7.6)	(40.8)	3.5	9.5	14.1
Russell 1000 Growth ("R1000G")	(3.6)	(22.6)	10.7	12.2	15.1

[1] ITD = inception-to-date, annualized. Inception date is 1/1/2009.

During the third quarter our portfolio underperformed in a down market. The major indices all fell, with the Dow down 6.7%, the S&P 500 down 5.3%, and the NASDAQ down 4.1%. The Russell 1000 Growth Index declined 3.6%, while Ithaka's composite declined 7.5%. Ithaka's 390 basis points (bps) of underperformance was largely due to stock selection. Our portfolio demonstrated weak breadth and depth, with only 10 of 29 stocks we held all quarter, representing 35% of the names and 30% of the portfolio weighting, outperforming our benchmark.

At the portfolio sector level, Ithaka realized negative relative returns in three of the four sectors in which we hold active bets. Ithaka's slight outperformance in the Consumer Discretionary sector was able to fully offset slight underperformance in the Financial Services and Health Care sectors, leaving the Technology sector responsible for ~95% of the quarter's underperformance. Within Technology, the negative contributors could be found in the Semiconductor and Software-as-Service sub-sectors. Given the more cyclical nature of the Semiconductor industry, investors have been digesting and discounting a possible global recession and its potential impact on demand for semiconductors in the short term. Ithaka's SaaS names were relatively more punished than the rest of the portfolio due to their unique business structures, where a substantial majority of their profits are out in the future despite the companies incurring the costs to acquire those revenues in the present.

Contributors and Detractors

3Q22 TOP 5 CONTRIBUTORS (%)	RETURN	IMPACT
Netflix	34.7	0.5
MercadoLibre	30.0	0.5
Amazon.com	6.4	0.4
Chipotle Mexican Grill	15.0	0.4
PayPal	23.2	0.3

3Q22 TOP 5 DETRACTORS (%)	RETURN	IMPACT
ServiceNow	(20.6)	(1.6)
NVIDIA	(19.8)	(1.1)
Adobe	(24.8)	(0.9)
Microsoft	(9.1)	(0.8)
Mastercard	(9.7)	(0.7)

Top Contributors

Netflix, Inc. (NFLX)
Netflix is the world's largest internet television network, with ~220mm streaming members in nearly every country around the world. Netflix balances a large movie and TV show back catalog (i.e., not new releases) against a rolling and more limited selection of current releases in addition to developing its own original content, which has become substantially more important in recent years. The stock's outperformance in the quarter was driven by both buy-side investors and the Street starting to discount the potential upside of Netflix's brand-new advertising-supported subscription tier, slated to launch at the end of this year. This new advertising tier, in conjunction with other tactics, is being recognized as an effective way to convert a meaningful number of the ~100M non-paying pirates of Netflix's service into monthly payers.

MercadoLibre, Inc. (MELI)
MercadoLibre is the leading e-commerce network/platform in Latin America, connecting merchants and consumers through its industry-leading brands and technology. In addition to its e-commerce prowess, MercadoLibre also owns the dominant regional digital payments platform, MercadoPago. MercadoPago has recently made huge strides in processing payments for off-platform transactions in addition to its longstanding stronghold processing payments for on-platform transactions. MercadoLibre continues to benefit from a flywheel effect, as each business under the Mercado umbrella helps bring more users into the ecosystem, leading to more merchants and product availability, which attracts more users. In the quarter MercadoLibre's outperformance was concentrated around its 2Q22 earnings announcement that beat Street expectations on both the top- and bottom-line, sending shares up ~15%.

Amazon.com (AMZN)
Founded in 1994, Amazon has evolved from its early roots as an online bookstore to become one of the world's largest eCommerce retailers. At the end of 2021 Amazon stood poised to capture >55% of all online US retail sales, representing five times more share than the next closest competitor. In addition to eCommerce, Amazon Web Services ("AWS") has rapidly become the market leader in the outsourced cloud infrastructure business, and Amazon Advertising is garnering significant share in digital advertising, particularly product placement ads, thanks to consumers beginning their product searches on Amazon's site. Amazon's 2Q22 earnings report, in which the company beat Street estimates on the top-line and missed on the bottom, helped propel the stock up ~10%. Investors and analysts both applauded the strong growth in the company's AWS division in addition to the company's renewed focus on growing profitability by slowing hiring and rightsizing its distribution footprint.

Top Detractors

ServiceNow, Inc. (NOW)
Founded in 2004, ServiceNow has become the leading provider of cloud-based software solutions that define, structure, manage and automate workflow services for global enterprises. ServiceNow pioneered the use of the cloud to deliver IT service management ("ITSM") applications. These applications allow users to manage incidents and to plan new IT projects, provision clouds, manage application performance and build applications themselves. The company has since expanded beyond the ITSM market to provide workflow solutions for IT operations management, customer support, human resources, security operations and other enterprise departments where a patchwork of semi-automated processes have been used in the past. ServiceNow's stock fell in the quarter following some less than bullish comments about the current demand environment from its CEO, Bill McDermott. On an episode of Mad Money, McDermott stated "You're at 41-year high inflation. The dollar right now is the highest it's been in over two decades. We have interest rates rising. People worried about security. You've got a war in Europe. So, the mood is not great."

NVIDIA Corp. (NVDA)
NVIDIA is the market leader in visual computing through the production of high-performance graphics processing units (GPUs). The company targets four large and growing markets: Gaming, Professional Visualization, Data Center, and Automotive. NVIDIA's products have the potential to lead and disrupt some of the most exciting areas of computing, including: data center acceleration, artificial intelligence, machine learning and autonomous driving. The stock's underperformance in the quarter was due to global recessionary fears and the impact such a recession might have on consumer and enterprise demand for NVIDIA's products.

Adobe Inc. (ADBE)
Founded in 1982, Adobe is one of the largest and most diversified software companies in the world. It offers a line of products and services used by creative professionals and consumers for creating, managing, delivering, measuring, optimizing, engaging, and transacting with compelling content and experiences across personal computers, smartphones, other electronic devices and digital media formats. Adobe's stock price underperformance was concentrated around its earnings announcement, during which the management team announced its plans to acquire Figma, a market leader in the UI and UX design tool space, for $20B. The negative reaction was likely due to the purchase price, which has Adobe paying ~50x Figma's current Annualized Recurring Revenue of $400M.

Transactions

During the quarter we initiated no new positions and eliminated two positions, Shopify (SHOP) and Twilio (TWLO). Our trailing 12-month turnover decreased 40bps to 12.7% while our trailing 3-year average annual turnover increased 20bps to 13.6%[1].

Market Outlook

Ithaka claims no expertise in economic or market predictions, and top-down analysis plays a very minor role in our approach to investing. We typically take our cues on the markets and the economy from our companies' management teams as they discuss their business prospects, and industry outlooks, during quarterly calls. In aggregate, this quarter's messaging echoed the last. Retail focused companies continued to beat the drum on slowing consumer demand at a time when they are sitting on record high inventories, resulting in guidance for aggressive discounts into year end. From our more enterprise focused portfolio companies, management teams reiterated they are watching the macro environment closely. They have noted bigger deals requiring higher-level approvals and deal closings have been delayed as a result, but there have been few cancelations due to the macro environment thus far. The one subtle shift that has permeated all of our companies conference calls is a sharper focus on the "core" business all while looking for ways to limit excessive or unnecessary expenses. For some companies, this means rightsizing their office space or physical infrastructure footprints. For others, it means freezing new hires, or outright layoffs. For months management teams have been bombarded with recession prognostications and it seems they are either legitimately worried about the real economy or simply using the current environment to rein in costs after overextending with new hires in a persistently tight labor market. In either case, our portfolio companies are well capitalized and each has the ability to ride out fairly substantial economic turbulence with limited to no financing risk.

On the macro level, much like the last 10 months, market participants continue to be focused on the same key issues, the most pressing three being the level of inflation, the Fed's appetite for such inflation, and the market impact of the Fed's liquidity reduction actions. The market's volatility over the past year has been driven by multiple failed attempts to forecast a Fed pivot, with the market rallying when conviction of a pivot increases, only to sell off when a Fed governor comes out stating they will do whatever it takes to tame inflation. As it stands today, the futures market is pricing in an additional ~150bp of hikes between now and February 2023, which will result in a peak prime rate of 450bps-500bps (80% probability). Investors at large seem to have come to grips with this reality and have consequently reset public market valuations to a level more consistent with a higher discount rate. If the Fed does indeed stay the course, the market should return to a more normal operating environment, where a company's fundamental results, as opposed to central bank policy, drives investment returns. The upcoming crop of earnings announcements is slated to give investors an important read on consumer demand and the likelihood of this demand faltering, which will shed light on the potential size and depth of a recession. In part due to the market drawdown we are all experiencing, we end this letter as we always do, acknowledging that one's ability to digest, forecast, and accurately discount the above macro factors in order to determine when the ultimate bottom has been put in place is pretty much an exercise in futility. We therefore choose to stay fully invested and focused on our mission of creating wealth for our clients by owning, in size, the great growth stories of our day.

[1] Turnover Rate indicates the frequency of changes to the portfolio, and is calculated as the greater of the buys or the sells during the period as a percentage of the assets under management at the time of each transaction. The calculation eliminates the effect of client-directed cash flows. Average Annual Turnover is calculated based on a trailing three year period.

Risk Disclosure

Past performance is not indicative of future results. The performance shown is for the Ithaka US Growth Strategy Composite. All fully discretionary taxable and non-taxable accounts are added to the composite following the first quarter in which their ending market values equal or exceed $0.5 million. Results of individual accounts may vary from the composite depending on account size, timing of transactions and market conditions prevailing at the time of the transaction. The gross-of-fee performance does not reflect the payment of management fees and other expenses that are incurred in the management of an account. The net-of-fee performance includes the payment of such fees and expenses. Gross-of-fee performance and net-of-fee performance both include the reinvestment of all distributions, dividends and other income.

The performance shown is compared to the Russell 1000 Growth Index and the S&P 500 TR Index. The Russell 1000 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those companies from the Russell 1000 Index with high price-to-book ratios and high forecasted growth as compared to other companies listed in the Russell 1000 Index. The S&P 500 TR Index is a market-capitalization-weighted index that measures the performance of 500 leading publicly traded companies in the U.S. The index tracks both the capital gains as well as any cash distributions, such as dividends or interest, attributed to the components of the index. These broad-based securities indexes are unmanaged and are not subject to fees and expenses typically associated with managed accounts. Individuals cannot invest directly in an index.

The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions Ithaka makes in the future will be profitable or will equal the investment performance of the securities discussed herein. Investing in securities entails risk and may result in loss of principal.

The Ithaka Group, LLC (Ithaka) has entered into a written agreement with Cedar Partners, ltd. (Cedar), which requires Cedar to provide client relationship and marketing services to Ithaka, including the introduction of prospective advisory clients to Ithaka. Cedar is not affiliated with and has no relationship with Ithaka other than a contractual relationship governed by the agreement between Cedar and Ithaka. Ithaka compensates Cedar by the payment of an Annual Retainer plus an Account Fee equal to 20% of the investment management fees paid to Ithaka by clients introduced by Cedar. The retainer is paid during the term of the Agreement between Cedar and Ithaka. The Account Fee is paid for as long as the client's account is managed by Ithaka. Ithaka has a standard fee schedule and does not charge any additional amounts to clients who were marketed by Cedar to cover the amounts Ithaka pays to Cedar.

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