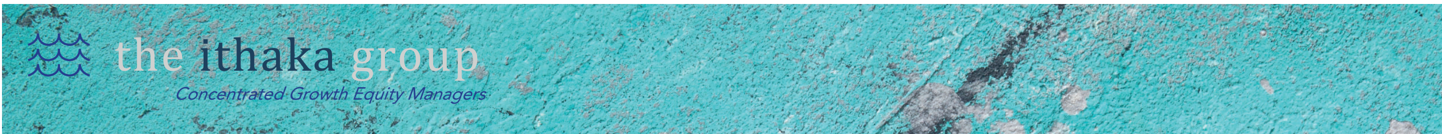


ITHAKA US GROWTH STRATEGY

FIRM OVERVIEW

- Founded in 2008
- Based in Arlington, VA
- 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: 01/01/09
- Benchmark: Russell 1000 Growth ("R1000G")
- ~$1B AUM
- 5 investment professionals

OBJECTIVE

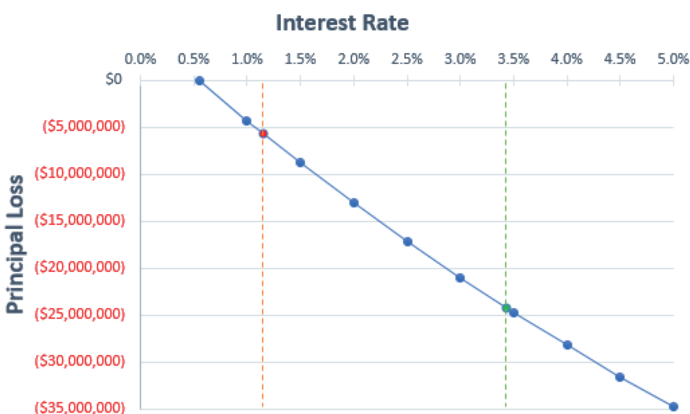
- Long-term growth of capital

PORTFOLIO MANAGERS

- Scott O'Gorman, CFA
- Andy Colyer, CFA

Market Review

Shelby Davis, the founder of investment firm Shelby Cullom Davis & Co., has been credited with saying, "You make most of your money in a bear market. You just don't realize it at the time." Said in our vernacular, "When the gun goes off, you've got to be there, you can't be trying to get there." The snapback in select equity markets during the first quarter offered yet another example of the perils of trying to time the market. Following a tumultuous 2022, during which investors lost money in almost every asset class, the beginning of 2023 saw risk assets appreciate materially. This strong performance transpired in the face of significant turmoil caused by some unforeseen knock-on effects from the Fed's ongoing fight against inflation. Following one of the most aggressive rate-hiking stints in the past 40 years, market participants have been left to assess, in real time, what the fallout from this tightening cycle might be. The first quarter of 2023 provided an answer few, if any, predicted—two major bank failures and the corresponding fear of system-wide contagion. The failures of Silicon Valley Bank ($209B in assets) and Signature Bank ($110B in assets) were only eclipsed by one other—the failure of Washington Mutual Bank ($307B in assets) in September of 2008. Unlike the Great Financial Crisis, today's crisis was not due to questionable loans handed out by greedy banks, but instead to the actions taken by banking executives (maybe still greedy?) during an unprecedented period of extremely low rates.



Source: Macrotrends.net

What's clear now is that the risk these banks were taking on the asset-side of their balance sheets was not fully understood. The chart above shows how rising rates affect the value of a $100M bond portfolio composed of 10-year US Treasuries bought at a cycle low yield-to-maturity of 55bps. This portfolio would earn $5.5M in cumulative interest over the 10-year holding period, but would expose the asset holder to significant losses should rates increase. In fact, the interest earned for the entire 10-year period could be wiped out if the yield on the 10-year note rose a meager 60bps to 1.15% (red line). Compare this to the current rate of 3.4% (green line) and you can see how detrimental these rate increases have been on bond portfolios. There is an argument to be made that all of this was the Fed's fault in the first place. By pushing borrowing costs near zero, the Fed enticed banks to invest in the current on-the-run securities, thus exposing them to undue interest rate risk on these assets. This became problematic when depositors came asking for higher returns on their deposits, or worse, a return of their deposits, potentially exposing the banks to insolvency. But what's done is done, and now it appears the Fed has put itself in an even more difficult position. At the March Fed meeting the voting members decided to raise borrowing costs another 25bps to a new range of 4.75%-5.00% while keeping their forward forecast unchanged at 5.00%-5.25% exiting 2023. While this update breathed some life into the "pivot" camp, Jerome Powell continued to emphasize the importance of pressing forward with rate hikes to help put an end to this relentless inflation. As has been the case for the past few quarters, the market is not completely aligned with the FOMC's forecasts and is betting rates will end 2023 somewhere between a half point and three-quarters of a point lower than they are right now. Only time will tell how this plays out, but if history is any guide, we will likely end up somewhere in between these two forecasts.

1Q23 Performance

PERFORMANCE (%)	1Q23	1 YR	3 YR	5 YR	ITD[1]
Ithaka US Growth Strategy (Gross)	21.8	(12.2)	13.6	13.1	16.2
Ithaka US Growth Strategy (Net)	21.7	(12.7)	13.0	12.5	15.6
Russell 1000 Growth ("R1000G")	14.4	(10.9)	18.6	13.7	15.8

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

During the first quarter Ithaka's portfolio outperformed in a strong market. The Dow rose 0.4%, the S&P500 rose 7.0%, and the NASDAQ rose 16.8%. The Russell 1000 Growth Index rose 14.4%, while Ithaka's composite gained 21.8%. Ithaka's 740 basis points (bps) of outperformance was due almost entirely to stock selection, with a very slight benefit from sector allocation. Our portfolio demonstrated modest breadth and depth, with 16 of 27 stocks we held all quarter (representing 60% of the names and 59% of the portfolio weighting) outperforming our benchmark.

At the portfolio sector level Ithaka realized positive relative returns in three of the four sectors in which we hold active bets. Within Technology, our relative overweight to semiconductor companies trounced weakness seen across our Software-as-a-Service holdings. Stock selection in the Health Care sector was strong across the board, with 5 of our 6 holdings positively contributing to returns. Strong stock selection was enough to offset an 85bp headwind from our overweight to the sector. Ithaka's outperformance in the Consumer Discretionary sector was concentrated in our e-commerce holdings, slightly offset by weaker performance in some of our brick-and-mortar retailers. Our slight underperformance in the Financial Services sector was entirely due to sector allocation, where our ~8ppt relative overweight cost the portfolio 90bps.

Contributors and Detractors

1Q23 TOP 5 CONTRIBUTORS (%)	RETURN	IMPACT
NVIDIA	90.4	5.0
salesforce.com	50.7	1.7
Microsoft	20.6	1.7
Apple	27.1	1.4
ServiceNow	19.7	1.3

1Q23 TOP 5 DETRACTORS (%)	RETURN	IMPACT
Intuitive Surgical	(3.7)	(0.2)
Snowflake	2.0	0.0
PayPal	6.6	0.1
DexCom	2.6	0.1
Block	9.3	0.1

Top Contributors

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 appreciation in the quarter was twofold. First, the stock benefited from tremendous excitement surrounding the release of more advanced chatbots, specifically ChatGPT, and the likelihood this would necessitate the purchase of a large number of Nvidia's products far into the future. Second, Nvidia posted a clean beat and raise quarter in mid-February, with investors becoming increasingly convinced the company and its suppliers are adequately working through the build up in channel inventories, which is reducing overall fears of ongoing inventory write-offs.

Salesforce, Inc. (CRM)
Salesforce is the largest pure-play cloud software company, holding a leading market share in customer relationship management applications and a top-five market share position in the company's other clouds (Marketing, Service, Platform, Analytics, Integration, and Commerce). The company's software subscription term-license model differs from the traditional perpetual-license software model in two respects: (1) the software is hosted on centralized servers and delivered over the internet, as opposed to traditional enterprise software that is loaded directly onto customers' hard drives or servers; and (2) the revenue model is subscription-based, typically charging monthly fees per user as opposed to charging one-time licensing fees. The stock's strong relative performance followed a strong F4Q23 earnings release that easily beat Street expectations on the top- and bottom-lines. In addition to the beat, management announced a number of initiatives that activist investors have been clamoring for, specifically a halt to large M&A transactions and a focus on operating profitability.

Microsoft Corporation (MSFT)
Microsoft builds best-in-class platforms and provides services that help drive small business productivity, large business competitiveness, and public-sector efficiency. Microsoft's products include operating systems, cross-device productivity applications, server applications, software development tools, video games, and business-solution applications. The company also designs, manufactures, and sells devices, including PCs, tablets, and gaming/entertainment consoles that all integrate with Azure, its cloud computing service. In the quarter Microsoft's stock appreciated on the back of excitement surrounding the company's investments in OpenAI and the potential opportunities to take search market share away from its dominant competitor, Google.

Top Detractors

Intuitive Surgical, Inc. (ISRG)
Intuitive Surgical is a medical device company that sells the da Vinci robotic surgical system. This system is primarily used for hysterectomy, prostatectomy, cholecystectomy, and hernia repair surgeries. The da Vinci systems are designed for minimally invasive surgery, which has the benefits of reduced pain, blood loss, and recovery time compared to traditional laparoscopic surgery. The company's revenues are generated from three main areas: 1) system sales, 2) instruments & accessories (scalpels, cauterization instruments, graspers, etc.), and 3) maintenance, repair, training and support. The stock's first quarter underperformance followed the company's earnings release in late January, where despite delivering a healthy 18% y/y procedure growth, investors were disappointed by management's commentary that: there will not be a new surgical

system released in 2023, and for the second year in a row margins would experience some deterioration.

Snowflake, Inc. (SNOW)
Snowflake is a dominant player in the Data Warehousing market, offering customers the ability to break down data silos and derive value from rapidly growing data sets through Snowflake's analytical database product, the Data Cloud. The company's base business is benefitting from a number of secular tailwinds, the three most prevalent being: 1) data-driven decision making, 2) cloud adoption, and 3) the exponential growth of corporate data. The company's visionary management team, headed by industry veteran Frank Slootman, plans to capture its fair share of this growth through: 1) executing on its land and expand model, 2) acquiring new customers, 3) growing internationally, and 4) expanding its nascent partner network. The stock's negative contribution in the quarter was due to the timing of Ithaka's purchase (mid-February) and its small portfolio weighting (100bps).

DexCom, Inc. (DXCM)
DexCom is a medical device company focused on the design, development and commercialization of continuous glucose monitoring (CGM) systems for people with diabetes. Diabetes is a chronic, life-threatening disease for which there is no known cure. DexCom's CGM system is superior to traditional finger-stick tests because it provides users with continuous data (including glucose trends and time spent in hyper or hypoglycemia) versus a snapshot in time. DexCom's stock traded ~flat in the quarter following a 5 month stretch where the stock doubled trough to peak, likely inducing some investor to take profits.

Transactions

During the quarter we initiated two new positions, Intuit (INTU) and Snowflake (SNOW) and eliminated two positions, Burlington Stores (BURL) and Qualcomm (QCOM). Our trailing 12-month turnover increased 150bps to 8.6% while our trailing 3-year average annual turnover hardly budged, increasing 30bps to 14.3%.[1]

Market Outlook

Ithaka claims no expertise in economic or market predictions, and top-down analysis plays a 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. The most recent earnings season was the first in the last 12 months where individual company results seemed to finally play a larger role than the current macro environment. At the individual holdings level, we had 80% of our holdings beat top- and bottom-line expectations, sending the average stock up ~4%, seven stocks up >10%, and only one stock down >10%. The skew in the quarter was decidedly up. When looking past the numbers, there were two recurring themes that seemed to bubble to the top. The first is a familiar one (we have been writing about it for over a year), and that is a focus on cost containment, which manifested in a slowdown in hiring, and the continued rationalization of each company's footprint (employees, real estate, investments, etc.). The second theme is one that has been debated by growth and value investors alike for the last 50 years: the true costs associated with stock-based compensation ("SBC").

The debate around SBC has not been about its effectiveness, as most market participants would agree this payment structure helps align workers' performance with shareholders' interests. It's more about how the cost should be accounted for. Up to this point value investors have been screaming into the wind that SBC is a significant and real cost (through dilution), while growth investors have been more than willing to add back the non-cash cost to arrive at a higher non-GAAP earnings number, making a company's valuation look more reasonable. The most recent quarter brought about an interesting development, with a number of the most egregious SBC payers publicly stating that these skyrocketing compensation costs are indeed real and will now be targeted by cost conscious management teams. Ithaka's investment team believes this will be a positive development for our companies, as it likely signals the beginning of the end of the blank checkbook era with regard to employee compensation. While there might be an adjustment period in the short-term as investors work to understand how much of the SBC costs will be replaced with cash bonuses, once the pig is through the snake we could see a healthier employment ecosystem and structurally higher margins in the out years.

Our market outlook section wouldn't be complete without our obligatory musings on the Fed's future policy decisions. As it stands today, the Fed is slated to hike rates 25 bps one more time in early May to a policy range of 5.00% to 5.25% and hold that range through the year as inflation (hopefully) continues to fall (currently sitting at 6% for a "negative" real fed funds rate of ~1%). Holding rates at this level for the remainder of the year would result in approximately eight months at the stepped-up (but no longer increasing) rate before beginning the debate about easing borrowing costs. Analyzing the past three rate-hike cycles, we note that once reaching its peak the federal funds rate held that level an average of 7.6 months before beginning its decent to lower levels. Only time will tell if a similar pattern will hold during this rate-hike cycle as the fed looks to orchestrate its first-ever soft landing.

As always, we end this letter acknowledging that one's ability to digest, forecast, and accurately discount the above macro factors is pretty much an exercise in futility, and 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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