

Portfolio Manager Commentary Second Quarter 2022

Portfolio / Index	Q2-22 Return	YTD 2022 Return	2021 Return	2020 Return	2019 Return	Since Inception CAGR
Focused Growth Composite	-23.7%	-35.2%	+13.1%	+45.3%	+37.3%	+6.5%
S&P 500 Total Return Index	-16.1%	-20.0%	+28.7%	+18.4%	+31.5%	+9.1%
Russell 1000 Growth Index	-20.9%	-28.1%	+27.6%	+38.5%	+36.4%	+10.6%

Returns are net of fees as of 6/30/22 and annualized if period is greater than 1 year

Dear Client,

Market conditions went from bad in Q1 to worse in Q2 and the stock market is off to the worst start to a year since 1970. The bear market in growth equities that began in November of 2021 continued in April and by June had broadened to more cyclical areas of the market. Continuing with the theme of no place to hide, rapidly rising interest rates meant that bond investors endured double-digit losses during the first half of the 2022 as well. Our Focused Growth portfolio is down 35% year-to-date which is entirely attributable to a sharp valuation reset. In fact, the weighted average earnings growth of the portfolio is still double-digits despite the more challenging macro environment. The growing earnings power of our portfolio companies coupled with their fortress like balance sheets make us confident of a strong rebound for these stocks once broader market sentiment improves. Over the long-term, portfolio returns will track earnings growth. However, the path from point A to point B is far from linear and more closely resembles a sine wave over a positive sloping line (the earnings growth of the portfolio is the slope of the line). The trip from the peak of that wave in November to where we are now has been painful and because the respective peaks and troughs of a cycle are often only apparent in hindsight we remain focused on the long-term slope of the line and the earnings growth of the portfolio. In our Q1 investor letter, we discussed the inflationary pressures facing the economy and the market reaction to prior Fed tightening cycles. In this letter, we will expand that discussion and analyze the path of equity returns during and around periods of economic recession. As always, we will tie this conversation back to the prospects for our portfolio companies.

The market is facing substantial macro-economic challenges, and uncertainty surrounding the timing and ultimate resolution of these issues is creating uncomfortable levels of volatility. The issues are well known and largely interrelated: Elevated Inflation, War in Ukraine, Fed Tightening Cycle, Recession Risk. Inflation remains at levels not seen since the early 1980s and May's 8.6% CPI reading triggered the sharpest weekly decline in equity markets since March of 2020. As much as I love to Monday morning quarterback politicians, I typically steer clear of doing the same for the Fed. I tend to give more grace to well-intentioned professionals seeking to navigate an impossibly complex world than I do to a group that tends to speak in soundbites while frantically seeking their next appearance on cable news. That said, neither group is going to emerge from the current inflationary period covered in glory. It seems to us that both the politicians and the Fed took the wrong lesson from the Financial Crisis and we are all paying the bill for that miscalculation now.

The Financial Crisis represented an existential threat to the global financial system. Political leaders and central banks around the world were forced to take unprecedented steps to avert the collapse of the banking system and numerous industries. The Federal Reserve lowered rates to 0% and began the process of quantitative easing,

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whereby certain fixed income markets were kept functional (i.e. rates kept from spiking out of control) by central bank purchases. Over the course of six years, starting in December of 2008, the Fed increased its bond holdings by \$3.7 Trillion in an effort to provide liquidity, reduce interest rates, and keep different fixed income markets functioning. This was unprecedented action, and although rampant inflation as a result of this action was widely predicted, it never came to pass. On the fiscal side of things, Congress passed an \$88 billion stimulus package in early 2009 to help pull the economy out of a deep recession. While we did emerge from recession, the ensuing recovery was one of the weakest on record and politicians wondered if they should have done more. Fast forward to the pandemic and the Fed's response was to cut rates to 0% again and from March 2020 through May 2022, the Fed balance sheet increased from ~\$4 trillion to \$8.5 trillion. This was more quantitative easing in two years than was utilized during a six year period following the financial crisis. The fiscal side of things is where the big difference lies. The US government spent roughly \$4.6 trillion in various relief programs during and after the pandemic, including a \$1.9 trillion relief package passed in March of 2021, which was after the economy was already in the midst of a torrid recovery. From the financial crisis, the Fed seemed to learn that the theoretical impact of quantitative easing (inflation) didn't occur in the real world while the politicians determined that the fiscal response to the financial crisis was lacking and that a robust recovery from an exogenous shock required a more robust fiscal intervention. In hindsight, we would submit that the financial crisis was a banking crisis and one that the global central banks needed to solve. Global financial markets were freezing and central banks as a backstop buyer were necessary to ensure their continued functioning. We just don't see how a global pandemic required a greater intrusion into fixed income markets than the financial crisis. The pandemic strikes us as a crisis where fiscal policy was needed to run point. With the exception of the \$1.9 trillion in additional stimulus passed after the economy was already in recovery, we view the fiscal response to the crisis as necessary. Something had to be done to keep small businesses and people separated involuntarily from their jobs during a lockdown afloat and the price of that something could be figured out later. The price is inflation and when you tally up the unnecessary size and length of the quantitative easing program, the "extra" \$1.9 trillion in stimulus to an economy already in recovery, disruptions in the global supply chain and the largest land war in Europe since WWII, the path back to the Fed's 2% inflation target is going to be a challenging one.

Whereas we believe that the primary tools needed to get us out of the pandemic ditch were of a fiscal rather than monetary nature, the path out of the inflationary ditch is certainly going to be Fed driven. Regardless of one's thoughts on the amount of PPP loans, the length of enhanced unemployment payments, or the size and number of stimulus checks sent out, one thing that we can all agree on is that the massive amount of fiscal stimulus distributed during the pandemic is not going to be repeated over the next several years. We can also probably agree that a major tax or spending bill of any kind is unlikely to be crafted and passed now that we are roughly 4 months from the mid-term elections. If we get a divided government result from those elections, go ahead and add another two years of fiscal inaction to the outlook. This means that the job of slowing the economy to the point that inflation is subdued without tipping the country into recession is left to the Fed. This is a hard job given that raising the Fed Funds rate is a blunt instrument with a lengthy time lag between action and impact. Increasing the level of difficulty at this particular time is that this is a process that is going to take place at the same time that the Fed is shrinking its balance sheet- i.e. selling down a portion of its massive fixed income portfolio. We are about to get real price discovery across numerous fixed income markets for the first time in 15 years and we are all curious as to what this will mean for interest rates. By its nature, the Fed is a slow moving entity. Luckily, the bond market is there to implement changes in real-time. While the Fed was still sitting at a Fed Funds rate of 75-100bps in early June, the 2 year bond was over 3% and mortgage rates had more than doubled from 2.75% at the start of the year to roughly 6%. While Jay Powell has made it clear that

the Fed Funds rate is going to 2.5% (the committees perception of neutral) and likely beyond this year, the economic impact of higher market rates is already being felt. The housing market has slowed dramatically, retail sales are under pressure and the draining of leverage from the system is likely to result in several high profile hedge fund failures. The 11 million job listings versus 5 million job seekers mantra is fool’s gold as we have already seen several high profile corporations reduce hiring plans or announce job cuts. The economy is slowing. High employment levels, strong consumer and corporate balance sheets, and a well-capitalized financial system are the offsets that give the Fed a chance to raise rates, reduce its balance sheet and slow the economy to curb inflation without causing a recession. A recession is not a foregone conclusion at this point, neither is a soft-landing. However, given the increased likelihood of a recession, now is a good time to look at what that could mean for equity returns.

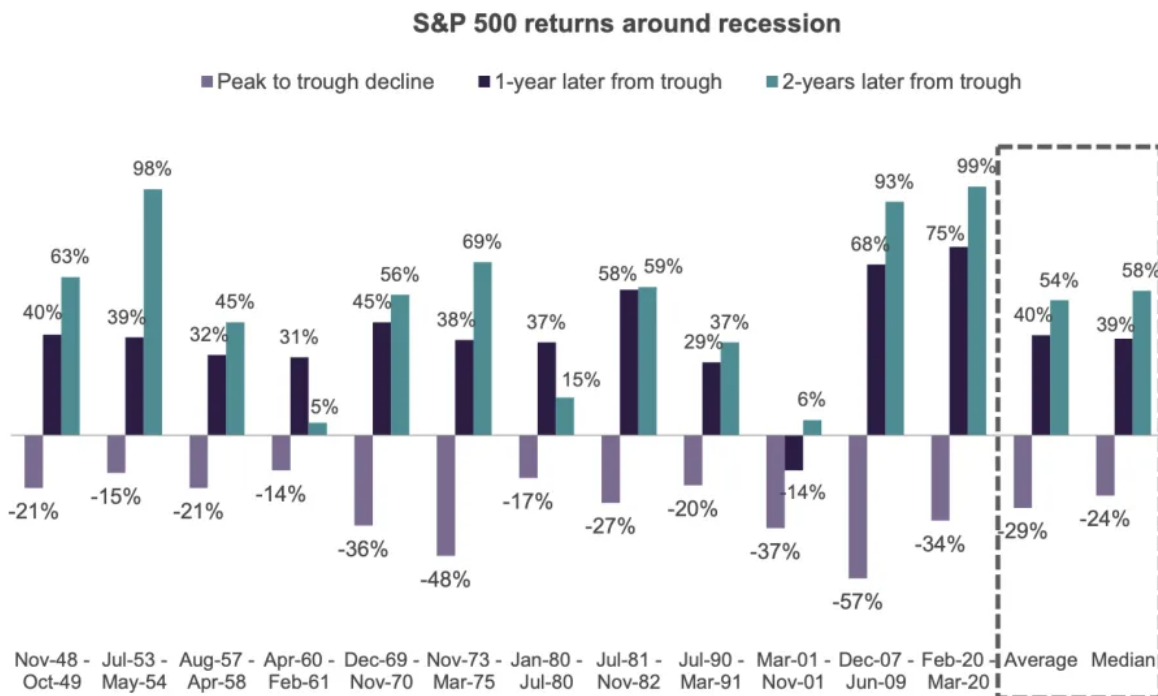


Figure 1 is a chart compiled by Truist Financial that looks at the S&P 500 returns around every recession since World War II. Before we dive into this chart, it is important to underscore that this analysis involves the 12 post-war recessions we’ve experienced and does not include the 50 recessions that experts have declared over that same period. My career in the investment management industry began in 1997, which means I experienced the last three recessions from the role of an investment professional. This makes me old enough to make noise when I bend down to tie my shoes but young enough to complete the task without pain. So, in my professional and pain free opinion, I can state that the nature of this downturn does not strike me as similar to the prior three. The pandemic is easy: we shutdown, stimulated, cut rates and reopened. Today’s challenge is more complex. The financial crisis was an event that took a decade to create and almost destroyed the way we have organized financially since the Great Depression. Our current issues aren’t in the same galaxy. The dot-com bubble gets a lot of comparison to the growth stock collapse we’ve seen since November, but I don’t think that comparison is entirely appropriate. The difference between now and then is that today’s technology sector contains some of the most cash generative businesses in the world as opposed to twenty years ago when the bulk of the technology sector was comprised of pre-earnings and sometimes pre-revenue businesses. While there are

certainly some of those businesses in today's market, they represent a small portion and don't exist in our portfolio. Further, the market destruction of the dot-com crash was compounded by the tragic events of 9-11. In my opinion, while every situation is unique, the current dynamic represents a mixture of the challenges faced in the 1990/91 recession (oil spike, coming off a war) and the 1981/82 recession (Fed induced slowdown to tame rampant inflation).

The most common and obvious question we get is "how much lower can the market go" and "where is the bottom". The dissatisfying answer we offer is that we don't know. With that out of the way, let's take a stab at where we are in this cycle and when this misery might end. The first point to make is that following the poor CPI numbers in mid-June, the S&P reached a depth of -24% from the highs, which represents the median decline for a recession. Basically, in mid-June the broader market baked in a normal recession. I'd also add that precisely when the market bottomed in mid-June, I came down with Covid for the second time and was quarantined through Father's Day. My personal bottom has been reached, maybe the same applies to the market. In terms of other yard markers we are looking for, the first and most obvious is for a decline in the monthly CPI numbers. This will indicate that we are at least on the right path with regards to inflation. Another item we'll be watching for is the market reaction to Q2 earnings. That numerous companies are either going to guide earnings down for the remainder of the year, withdraw guidance or at least offer some tepid commentary on the outlook is the worst kept secret on Wall Street. Any CFO that has concerns on the outlook would be crazy not take this opportunity to "reset" expectations. We want to see this occur without causing massive destruction to share prices. This wasn't the case for companies that missed the past two quarters and should we get another round of step function drops in stock prices for companies that miss in Q2 or offer lower guidance, it will indicate that while the market may have priced in many macro issues, it has yet to adjust to a reduced earnings outlook. On the other hand, there are few things more positive for a market than stocks that hold firm or rally on ostensibly bad news. Finally, we'll be monitoring market reaction to broader economic releases looking for the time when bad news equals good news. During the middle part of a cycle, good economic news typically equates to good market news because it indicates that the economy is growing at a healthy rate and should continue along that path. As we move to the later stages of a cycle and inflation concerns begin to creep in, good economic news can be bad market news as it can be interpreted to mean that the economy is running hot and the Fed will need to raise rates to curb potential inflation. This was the controlling dynamic from October 2021-June 2022. Once the Fed embarks on a tightening cycle, the focus turns to the soft landing versus recession debate, this is where we are now. That means that bad economic news is generally bad market news as it indicates an increasing chance of recession. Finally, we get to the point where bad economic news is good market news. This occurs when market participants are more focused on the end of a Fed tightening cycle and a shift from a hawkish stance towards a more neutral or even dovish stance than they are on a slowing economy. What makes interpreting this data and the market responses challenging is that these shifts rarely occur in a linear pattern, which means that the market is likely to send many contradictory signals as it searches for a clear direction.

Second Quarter Detractors:

In volatile periods like the present one, the market very much takes on a shoot first ask questions later approach with regards to stocks. The narrative around a stock or group of stocks carries the day, regardless of whether the negative story has more than its share of holes. This quarter, we are going to take a closer look at three of our holdings where we think the pessimism has become excessive and obscures a stronger underlying set of facts that we believe exist. Let's dig a little deeper into what is going on with Amazon, Intuitive Surgical and Nvidia.

Amazon: Amazon shares fell 33% during the second quarter driven by a first quarter earnings miss coupled with tepid second quarter guidance. While AWS and the advertising business, the primary profit engines, continued to demonstrate great strength, Amazon faced some challenges in its retail business. Amazon identified \$6B of additional expense in the first quarter due to inflation and over capacity on both fixed assets and employees that led to some loss of productivity and fixed cost deleverage. Further, the company expects an additional \$4B of related expenses in the second quarter. We think this issue will prove to be short-lived. From the beginning of the pandemic through the first quarter of 2022, Amazon effectively doubled its employee base (800K to 1.6M) and its warehouse footprint. The company continued to add employees following the seasonal fourth quarter peak in an effort to minimize disruptions from the winter spike in Omicron. Now, investment in personnel and warehouse capacity will slow and the company will grow into its new, much larger footprint. As it does, the fixed cost base will be leveraged and productivity gains will return. Inflation remains a wildcard, but even Amazon is beginning to pass along some of these costs to consumers. On the sales side of things, the bulk of the Q2 "shortfall" is attributable to moving Prime Day from late June in 2021 to mid-July this year. Again, not a material issue but in a market like this the benefit of the doubt is not currently granted to an economically sensitive company with an enormous retail business.

Intuitive Surgical: Intuitive is a great company with an enormous leadership position in soft tissue robotic surgery. As such, it commands a premium valuation. Historically, Intuitive has experienced sensitivity to its business related to hospital capital budgets. Naturally, when medical equipment companies, including Intuitive, noted that hospitals are taking a more cautious stance with regards to their capital equipment budgets, shares of Intuitive took a hit. We are not going to pretend that higher hospital equipment budgets aren't preferable to lower ones, but Intuitive is a much different company than the last time hospital budgets came under pressure. In prior cycles a hit to systems placements would cause material damage to the P&L. However, now roughly 75% of Intuitive's revenues are recurring in nature (instruments, services, lease payments) and procedure growth drives system placements. On that front, visibility remains poor given the rolling Covid lockdowns worldwide, but first quarter procedure growth of 19% was well ahead of expectations and management indicated that procedures remain closely related to Covid hospitalizations. This would seem to indicate that second quarter procedure numbers could again exceed expectations, at least domestically. Finally, since the last capital equipment cycle Intuitive has put in place an equipment leasing program whereby almost 40% of systems are placed via lease agreements. The point is that this is a much less cyclical business than the last time we faced an economic slowdown yet the market continues to treat it as a typical economically sensitive medical technology equipment company.

Nvidia: Semiconductors are among the most economically cyclical businesses and for the most part, that remains true. We think Nvidia's fully integrated stack of accelerated and programmable computer chip sets with direct exposure to the build out of the third party data center (the cloud) and leadership in artificial intelligence

and inference will help mitigate that cyclicity. Although its gaming business is facing a \$400M hit in the second quarter due to the withdrawal from Russia and the Chinese lockdowns, the data center business, which is now Nvidia’s largest segment, remains scorching hot (83% growth in Q1). Yes growth in data center will slow, but judging by the commentary from Amazon and Alphabet (two of the largest cloud players), capital spending plans remain very strong. The shift to cloud computing and increasing reliance on artificial intelligence are multi-decade trends. While we acknowledge that Nvidia will maintain some sensitivity to macro-economic conditions, we believe that the secular growth characteristics of its end markets will mitigate this volatility. As this becomes clearer, we expect the heightened level of concern in the stock to dissipate.

We’ve highlighted three companies whose stocks have been pressured to an extent far beyond what we view to be appropriate given the fundamentals. We could have extended this list dramatically. That said, complaining about near term market action is about as effective as a dog howling at the moon. But just as the market will outrun fair value on the upside, it overcorrects on the downside. When the dust settles from this current downdraft, the stocks that rebound the sharpest will be the ones where the fundamentals of the business turned out to be stronger than the broader market, at its darkest hour, judged them to be.

Second Quarter Portfolio Activity:

Table 1 shows the changes made to the portfolio during the quarter. The fact that we are fully invested coupled with the step function decline across so many stocks, meant that portfolio activity was limited in the second quarter. Because we did not see any fundamental breakdowns across our holdings during the quarter and everything effectively got cheaper in lockstep, there were few opportunities to make changes within the portfolio. That said, we did increase our position in Charter again in the second quarter with the proceeds coming from United Health and JD.com, which were our two best performing holdings during the period. This had the effect of pairing these holding back to their targeted weight while increasing our exposure to one of the top risk reward profiles in our portfolio.

Table 1:

New Purchases / Additions		
Company	Beginning Weight	Ending Weight
Charter	6.0%	8.0%

Individual account position changes may vary from the chart above due to various factors such as inception date or cash flows.

We’ve often contended that if you can answer three questions correctly about any stock, you will be right on that stock. The challenge is figuring out what the pertinent questions are and arriving at their correct answers. This is simply the process of figuring out the critical issues and avoiding getting bogged down in the world of the anecdotal and minutiae. In most cases, market consensus is reached on parts of the key issues while the debate that continues on the other parts is where excess returns can be generated. For Charter, at these levels, we think it comes down to a single question: Will cable maintain share in broadband internet or will it be supplanted by fiber to the curb or fixed wireless offerings? If Charter holds its share, cashflow will grow in the mid-single digit range and with the current valuation and the company’s policy on maintaining debt/EBITDA in the 4.0x-4.5x range, this stock will be a slow motion public leveraged buyout. If share loss results in sustained declines in cashflow, even with the company’s current free cash flow yield of roughly 10%, excess cash will go towards paying down debt rather than share repurchase and the stock will languish. In our view it’s that simple. Both

Comcast and Charter have traded on the quarter by quarter change in the number of net broadband additions and the deceleration of this number has pressured valuation to the point where persistent share loss and cash flow degradation is necessary to justify the current price.

So, now that we've identified the controlling issue for Charter, let's take a look at why we believe broadband distributed via the cable plant will maintain its leadership position in high-speed internet delivery. Let's start with fixed wireless broadband, which has been adding subscribers in recent quarters and is a relatively new high speed internet option. This has raised concern as both Comcast and Charter have seen weaker net additions during the same periods. However, a closer look shows that a material portion of fixed wireless additions is coming in rural areas without cable broadband or fiber to the curb broadband access and smaller, mobile business customers (think of businesses like food trucks). Most importantly, the fixed wireless gains have not shown any discernible impact to Charter's record low churn, which supports management's contention that this technology, while useful for those without better options, does not offer the speed or reliability of the cable or fiber to the curb networks. With data consumption only increasing, the need for faster network speeds increases and this is a critical competitive advantage for cable broadband and fiber to the curb. We don't believe this is a technology that will pose a material long-term threat to the incumbent broadband providers.

Fiber to the curb is a different issue. In contrast to fixed wireless, fiber to the curb has been competing with cable broadband for 15 years. It is also a technology that offers competitive performance in terms of speed and reliability. The issue is competitive intensity in areas where there is overbuild. There are two types of competitors to consider in this space- large telcos like AT&T and Verizon and Tier 2 private players. Starting with the well-capitalized telcos, overbuild on Charter's footprint has been in the mid-30s percent range and that number is expected to increase by 10%-15% in the coming years based on commentary from those companies. The advantage that the cable companies hold in this battle is that it is materially cheaper to boost speeds to the existing cable plant than it is to build out fiber to the curb. This means they can generate attractive returns on invested capital at lower prices. Another silver bullet held by the cable industry is their incursion into the mobile wireless market. Whereas it is enormously expensive and time consuming for wireless telcos to build out a competing broadband offering in hopes of offering consumers a bundled telecommunication option, it is really cheap and pretty fast for the cable companies to offer their customers a wireless option. This is because both Comcast and Charter have perpetual MVNO agreements with Verizon that allow them to access its nationwide wireless network at wholesale prices. While this is a thin margin business it is one that can be offered to consumers at minimal marginal cost. Further, the cable companies can cherry pick high volume areas to purchase their own spectrum which will allow them to capture higher margins over time. We believe this puts the cable companies in a much stronger relative competitive position to the telcos in going after a consumer's entire telecommunication bill. Because cable is the low cost option on both sides of the equation, the incentive for the telcos to engage in a destructive price war does not exist. As for Tier 2 private fiber overbuilds, Charter COO Chris Winfrey addressed this on the most recent earnings call and noted the long history of these competitors- they start with great fanfare and raise capital when liquidity is high and capital is cheap, they add some customers and hope to sell to a larger player, if a sale doesn't happen they go bankrupt and have to be recapitalized. Lather, rinse, repeat. To sum up, we think that concerns over heightened competitive intensity offer an opportunity because broadband cable is a better product than fixed wireless, a cheaper alternative to fiber to the curb, and has financial staying power that Tier 2 fiber players do not.

BURKE WEALTH MANAGEMENT

J.P. Morgan once said, “in bear markets, stocks return to their rightful owners”. Putting aside the elitist nature of this statement, the broader point that bear markets chase the speculators from the field while the long-term investors hold the course with good businesses is valid. The broader market is off to its worst start since 1970 and with much of the damage focused on growth businesses, this is easily the most challenging investing environment I’ve encountered in my 25 years in the industry. The confidence I have in the businesses we own and the belief that the growing earnings power of this portfolio will drive returns over time is what I draw on when the market action is bleak. That is the light we will focus on through this storm and this storm will pass. We thank you for the trust you have placed in us and as always, please don’t hesitate to reach out if you have any questions or topics you would like to discuss in greater detail.

Regards,



Ken Burke
Chief Investment Officer

Disclosure

The Burke Wealth Management Focused Growth Composite, created on October 1, 2018, contains fully discretionary large cap equity accounts that is measured against the S&P 500 Total Return Index and the Russell 1000 Growth Index. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The Burke Wealth Management Focused Growth Strategy invests exclusively in a portfolio of high-quality companies.

The S&P 500® Total Return Index is a widely recognized, unmanaged index of 500 common stocks which are generally representative of the U.S. stock market as a whole. Ordinary dividends are reinvested across the index and accounted for in the Total Return index calculations. The Russell 1000® Growth Index is an unmanaged index that measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values.

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Past performance does not guarantee future results and future accuracy and profitable results cannot be guaranteed. Composite performance figures are presented gross of management fees and have been calculated after the deduction of all transaction costs and commissions. For existing clients, accompanied with this investor letter is the client billing statement, which includes gross and net returns of individual accounts.

The management fee schedule is as follows: Per annum fees for managed accounts are 100 basis points of the first \$5,000,000 of assets under management, 75 basis points of the next \$5,000,000 of assets under management, and 50 basis points of amounts above \$10,000,000 of assets under management. Investment management fees may be negotiated and will vary due to certain factors, including but not limited to: the number, type, and size of the account(s); the range and frequency of additional services provided to the client and account(s); the value of the assets under management for the client relationship; and/or as otherwise agreed with specific clients. Burke Wealth Management, LLC is a registered investment advisor in the state of Texas and its investment advisory fees are described in its Form ADV Part 2A. The advisory fees will reduce clients' returns.