JUNE 30, 2024

# Balanced Fund

SECOND QUARTER RESULTS

MAIRS & POWER

Focused Long-term Investing

# Market Overview | Second Quarter 2024

The Federal Reserve (Fed) continues to make progress in its effort to balance economic growth with inflation. However, the stock market has been anything but balanced, with a handful of stocks generating nearly all the market returns so far this year. Though the S&P 500 ended the quarter on another up note, the index's overall positive performance was again driven by a narrow group of stocks. So far in 2024, 64% of the market's return can be attributed to seven names (Alphabet, Amazon, Apple, Eli Lilly, Meta, Microsoft, and Nvidia). At the same time, 75% of S&P 500 stocks are underperforming the index, 38% have had negative returns, and only two sectors out of 11 outperformed the index (Technology and Communication Services).

Looking at the indices for the second quarter, the S&P 500 Total Return (TR) was 4.28% and is 15.29% year-to-date. The Dow Jones Industrial Average Total Return (TR) was -1.27% in the quarter and 4.79% year-to-date, and the Bloomberg U.S. Government/Credit Bond Index return was 0.05% in the second quarter and -0.68% year-to-date.

Several key economic indicators pointed to a slowdown in the second quarter. Job growth softened with the unemployment rate rising to 4.1% in June, up from 3.6% a year ago at this time. Additionally, job growth slowed, averaging 177,000 new jobs per month in Q2, down from an average of 267,000 in Q1. In late June, the U.S. Labor Department reported that the total number of Americans collecting jobless benefits reached the highest level in more than two years. Wage inflation, which had been stubbornly high, is also slowing. In June, wages were up 3.9% from a year ago, and that compares with a 4.7% rate of increase at this time last year.

As job growth has slowed, consumer confidence has also declined, leading to weakened retail sales growth. In June, retail sales increased to an annual rate of only 2.3%, down from a 5.5% growth rate in December. Existing home sales also declined again in the second quarter after improving a bit earlier in the year. The National Association of Realtors reported that on an annualized basis, sales of existing homes fell to 4.1 million in May. That compares to a rate of 5.1 million two years ago and a peak of 6.7 million back in 2021 when mortgage rates were low.

# Future Outlook

Despite economic growth slowing in the second quarter, there are reasons to feel cautiously optimistic. The Fed's preferred measure of inflation, the personal consumption expenditures price index (PCE), was up 2.6% in May from a year earlier compared to a year-over-year increase of 3.2% at this time last year. That's the direction the central bank would like to see sustained and increases the likelihood of the central bank cutting rates in the coming months.

The Fed's mandate is to balance employment and inflation. An economy in equilibrium creates enough new jobs that keep incomes, spending, and investment growing without causing inflation to accelerate. This can lead to a broad economic expansion into the future.

Rate reductions also could bring greater balance to the overall market. This year, the biggest companies have posted the largest earnings growth, a key driver of market performance. Estimates for the S&P 500 continue to be revised upward for 2025 and 2026, boosted by the megacap stocks mentioned earlier. However, earnings for small and midsize companies have been less robust. Earnings estimates for the S&P Small Cap 600 Index in 2025 and 2026 have seen consistent downward revisions. That's because most smaller companies need to borrow to fund their growth. Unlike the bigger businesses, they do not have large cash reserves or enjoy high levels of cash flow. Current high interest rates have elevated borrowing costs, cutting into smaller companies' earnings. This helps explain the weaker market performance of small cap stocks. Interest rate cuts could boost earnings growth for smaller companies, leading to better performance for all stocks and sectors.

A key aspect of our job as investment managers is balancing potential return against potential risk. We do this in several ways, but it is critical to exhibit valuation discipline that trims positions when they become expensive and adds to those positions when valuations become attractive. At first glance the stock market appears to be overvalued compared to the 10-year average. However, a closer look shows that much of this overvaluation is due to the AI-fueled technology boom surrounding the largest 10 companies. The remaining 490 companies trade at a much more reasonable valuation, right in line with the historical average. While we remain positive on the long-term prospects for AI, our valuation discipline is helping us find opportunities in other parts of the market. We will continue to examine opportunities to invest in well-run companies exhibiting durable competitive advantages that we believe are attractively priced.

**Past performance is not a guarantee of future results.**

# Performance Review

**The Mairs & Power Balanced Fund finished the first half of 2024 up 5.48%. The Fund lagged the benchmark composite index (60% S&P 500 Total Return Index and 40% Bloomberg U.S. Government/Credit Bond Index), which was up 8.71%, and the Fund underperformed the Morningstar Moderate Allocation peer group, which rose 6.50%.**

*Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. For the most recent month-end performance figures, please call Shareholder Services at (800) 304-7404. Expense Ratio 0.71%.*

The Fund continues to have an overweight to stocks, which slightly benefited performance as stocks outperformed bonds during the period. Stocks rose during the period as continued strength in the economy helped support expectations for earnings growth, while bonds had modest positive total returns as earned interest overpowered fluctuations in bond prices.

Over the last year and a half, a narrow grouping of stocks has driven a significant portion of stock market returns. Much of this excitement relates to the opportunities stemming from the development and deployment of generative artificial intelligence (AI) technology. However, our diversified approach left our portfolio underexposed to this narrow leadership group, causing the Fund's equity performance to lag the benchmark during the period.

The Technology sector was the largest contributor to the Fund's lagging equity performance in the first half due to an underweight allocation combined with relative underperformance of individual holdings. Most of the Technology sector's performance gap can be explained by the absence of Nvidia (NVDA) from the portfolio. Negative trends in consumer electronics, industrial, and automotive during the period impacted our holding in Littelfuse (LFUS). Positively, the bottom of the semiconductor cycle appears to be in as an improving demand outlook and normalization of inventory levels benefited holdings such as Entegris (ENTG), Texas Instruments (TXN), and Qualcomm (QCOM).

The Industrials sector showed clear signs of slowing economic growth, so the Fund's overweight allocation to the sector detracted from relative performance during the first half. Graco (GGG) saw broad-based sales declines that led to a modest decrease in earnings estimates. Industrial parts distributor Fastenal (FAST) underperformed during the period due to a softening manufacturing environment. nVent (NVT) positively contributed to returns with better than expected revenue largely due to data center cooling solutions growth, as well as good expense control leading to better operating margins. We eliminated our position in United Parcel Service (UPS) during the period as we expect the shipping environment to remain challenging for an extended period of time.

The Healthcare sector was challenged during the first half of the year, so the Fund's overweight allocation adversely impacted relative performance. UnitedHealthcare (UNH) underperformed during the period due to higher payouts for healthcare provision, a recent cyberattack, and news that the United States Department of Justice was opening an antitrust probe against the company. Medtronic (MDT) also underperformed as earnings guidance was weaker with new product uptake not contributing to growth as much as investors generally expected. Conversely, the optimism for Eli Lilly

(LLY) surrounding its Zepbound branded weight loss treatment helped it outperform meaningfully. We have continued to trim the Fund's position in Lilly due to its extended valuation, and we also trimmed the Fund's holdings in Bio-Techne (TECH) given lowered expectations for future growth.

**Robert W. Thompson, CFA**
Co-Manager
*left*

**Kevin V. Earley, CFA**
Lead Manager
*right*

The Fund's underweight allocation to the consumer segments helped relative performance as the sectors generally lagged on weaker consumer numbers, and selection also aided relative performance. Both Hormel (HRL) and Hershey (HSY) have been mired in the expectations that GLP-1 usage will impact future consumption of products from each company. Hershey doubly dealt with runaway cocoa prices due to three years of low cocoa production in West Africa causing shortages. This sector weakness has provided an opportunity to add two new names in the consumer space: Casey's General Stores (CASY) and Procter & Gamble (PG). Casey's operates convenience stores and gas stations located across the Midwest, with a focus on rural areas where it is often the go-to store for minor trips. The company is a high-quality operator, and it is positioned to perform well even in the face of an eventual transition to electric vehicles due to its rural/exurban footprint. Procter & Gamble has durable competitive advantages due to its portfolio of well-known consumer brands, including Tide, Crest, and Swiffer.

Lastly, we added Ameriprise (AMP) to the portfolio during the first half of the year. Ameriprise has an enviable position within the wealth management space where it services high-net-worth clients through its network of over 10,000 advisors. The company appears poised for continued share gains as it has consistently posted healthy flows in its wealth management business.

At the end of 2023, the prevailing notion in fixed income markets was that interest rates were going to decline, and that they were going to decline fast. The strength of the US economy helped shift that narrative, as the 10-year yield rose from 3.88% at year-end to 4.35% at the end of the second quarter. Along with the economic strength, corporate bond spreads have reached low levels largely unseen since the financial crisis, offering less additional compensation to bondholders for taking on credit risk. The Fund's fixed income portfolio is overweight to corporate bonds and is generally shorter duration than the index. Both factors worked in the Fund's favor during the first half of the year, leading to relative outperformance on the fixed income portfolio. Positively, at this point the majority of the return is being driven by the yield of the portfolio and not movements in interest rates. We continue to execute on our strategy in fixed income, whereby we seek pockets of value and selectively research and buy bonds to help us achieve long-term outperformance.

We continuously assess conditions to determine how the rate outlook could impact each company from both an earnings and valuation perspective. We prefer companies with durable competitive advantages and attractive long-term growth prospects as this generally leads to sustainable investment returns. The

Return on equity (ROE) is the measure of a company's net income divided by its shareholders' equity.
Duration is a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates.

Fund's equity style was less in vogue last year as our tilt toward dividend stocks at reasonable valuations led us to be underweight the narrow megacap leadership group which has led the market. With current rates portending better fixed income returns, we continue to slowly increase the fixed income weighting in the portfolio while keeping duration in check and seeking opportunities to improve credit quality in the face of tight credit spreads. We believe our consistent investment approach to both stocks and bonds will deliver sustainable performance over the long haul.

## Mairs & Power Balanced Fund Contributors

**Year-to-Date (%) 12/31/2023—6/30/2024**

| LARGEST CONTRIBUTORS TO RELATIVE PERFORMANCE | | LARGEST DETRACTORS FROM RELATIVE PERFORMANCE | |
|---|---|---|---|
| Eli Lilly & Company | 55.84 | Xcel Energy Inc. | -11.93 |
| QUALCOMM Inc. | 39.00 | Graco, Inc. | -8.09 |
| Alphabet Inc. Class C | 30.30 | Bio-Techne Corporation | -6.94 |
| Ecolab Inc. | 20.57 | U.S. Bancorp | -6.11 |
| JPMorgan Chase & Co. | 20.34 | Microsoft Corp.* | 19.29 |

*Since the Fund is underweight Microsoft Corp. relative to the benchmark, the stock's strength in the second quarter contributed negatively to relative performance.

Largest relative contributors and detractors are securities that were selected based on their contribution to the portfolio as of June 30, 2024. The performance number shown is total return of the security for the period and includes only securities held for the entire period. Total return is the amount of value an investor earns from a security over a specific period and when distributions are reinvested. Past performance does not guarantee future results.

***The Fund's investment objective, risks, charges and expenses must be considered carefully before investing. The summary prospectus or full prospectus contains this and other important information about the Fund and they may be obtained by calling Shareholder Services at (800) 304-7404 or by visiting www.mairsandpower.com. Read the summary prospectus or full prospectus carefully before investing.***

The stocks mentioned herein represent the following percentages of the total net assets of the Mairs & Power Balanced Fund as of June 30, 2024: Alphabet Inc. 4.03%, Amazon.com 0.00%, Ameriprise Financial Inc. 0.67%, Apple Inc. 0.00%, Bio-Techne Corp. 0.85%, Casey's General Stores Inc. 1.05%, Ecolab, Inc. 2.15%, Eli Lilly & Company 2.07%, Entegris Inc. 0.90%, Fastenal Co. 1.07%, Graco Inc. 1.41%, Hershey Co. 1.14%, Hormel Foods Corp. 1.22%, JPMorgan Chase & Co. 2.67%, Littelfuse 1.47%, Medtronic PLC 1.84%, Meta Platforms Inc. 0.00%, Microsoft Corp. 4.11%, NVIDIA Corp. 0.00%, nVent Electric PLC 0.71%, Procter & Gamble Co. 0.80%, Qualcomm Inc. 1.73%, Texas Instruments Inc. 2.19%, United Parcel Service 0.00%, UnitedHealth Group Inc. 2.80%, US Bancorp 1.15%, Xcel Energy Inc. 1.29%.

All holdings in the portfolio are subject to change without notice and may or may not represent current or future portfolio composition. The mention of specific securities is not intended as a recommendation or an offer of a particular security, nor is it intended to be a solicitation for the purchase or sale of any security.

## Average Annualized Returns (%) as of 6/30/2024

| Fund/Index | 1 YR | 5 YR | 10 YR | 25 YR | SINCE INC |
|---|---|---|---|---|---|
| **Mairs & Power Balanced Fund**[1] | **11.43** | **7.33** | **6.78** | **7.20** | **9.37** |
| Composite Index[2] | 15.48 | 9.08 | 8.45 | 6.49 | 8.95 |
| Morningstar Category[3] | 12.70 | 7.00 | 5.90 | 5.03 | — |
| S&P 500 TR Index[4] | 24.56 | 15.05 | 12.86 | 7.67 | — |
| Bond Index[5] | 2.74 | -0.07 | 1.51 | 3.98 | — |

Expense Ratio 0.71%

Inception 1/10/1961

*Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. For most recent month-end performance figures call Shareholder Services at (800) 304-7404.*

[1] Performance information shown includes the reinvestment of dividend and capital gain distributions, but does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares.

[2] The Composite Index reflects an unmanaged portfolio of 60% of the S&P 500 TR Index and 40% of the Bloomberg Barclays U.S. Government/Credit Bond Index. It is not possible to invest directly in an index.

[3] Morningstar Moderate Allocation Category seeks to provide both capital appreciation and income by investing in three major areas: stocks, bonds, and cash. These portfolios tend to hold larger positions in stocks than conservative-allocation portfolios. These portfolios typically have 50% to 70% of assets in equities and the remainder in fixed income and cash. It is not possible to invest directly in an index.

[4] The S&P 500 TR (Total Return) Index is an unmanaged index of 500 common stocks that is generally considered representative of the U.S. stock market. It is not possible to invest directly in an index.

[5] Bloomberg Government/Credit Bond Index is a broad-based flagship benchmark that measures the non-securitized component of the U.S. Aggregate Index. It includes investment-grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related and corporate securities.

Dow Jones Industrial Average TR Index is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.

The ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms.

The Russell 1000 Index represents the top 1000 companies by market capitalization in the United States. The Growth index is composed of large- and mid-capitalization U.S. equities that exhibit value characteristics . The Value index is composed of large- and mid-capitalization U.S. equities that exhibit value characteristics.

One cannot invest in an index.

**Risks:** All investments have risks. Mairs & Power Balanced Fund is designed for long-term investors.

The Fund's share price can fall because of weakness in the broad market, a particular industry or specific holdings. Investments in small and midcap companies generally are more volatile. International investing risks include among others political, social or economic instability, difficulty in predicting international trade patterns, taxation and foreign trading practices and greater fluctuations in price than U.S. corporations. The Balanced Fund is subject to yield and share price variances with changes in interest rates and market conditions. Investors should note that if interest rates rise significantly from current levels, bond total returns will decline and may even turn negative in the short-term. There is also a chance that some of the Balanced Fund's holdings may have their credit rating downgraded or may default.

Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower rated and non-rated securities present a greater risk of loss to principal and interest than higher rated securities.

This commentary includes forward-looking statements such as economic predictions and portfolio manager opinions. The statements are subject to change at any time based on market and other conditions. No predictions, forecasts, outlooks, expectations or beliefs are guaranteed.

Foreside Fund Services, LLC. is the Distributor for Mairs & Power Funds.

M&PI-575610-2024-07-17

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