

April 30, 2024

Dear clients and friends,

Unlike firms that lead with financial planning services, Sapphire is focused on investment research and portfolio management.

Many moons ago, I learned about Michael Porter's 5 Forces in his book *Competitive Advantage* during my capstone MBA course at Case Western Reserve University. Michael Porter was a professor at Harvard Business School and his 5 Forces framework is an especially helpful tool that we use to analyze the competitive landscape of an industry. The 5 Forces are:

- Threat of new entrants
- Bargaining power of suppliers
- Bargaining power of buyers
- Threat of substitute products or services, and
- Rivalry among existing firms

Recently, we discovered Hamilton Helmer's *7 Powers: The Foundations of Business Strategy*. Hamilton Helmer is the co-founder and chief investment officer of an investment management firm and was a professor at Stanford. In our view, his 7 Powers framework is a sharp tool that applies directly to our security selection process. The 7 Powers help us assess company-specific competitive advantages that can lead to sustainable earnings power of a business. The 7 Powers are:

- Scale economies
- Network effects
- Counter-positioning
- Switching costs
- Branding
- Cornered resource, and
- Process power

In thinking about the ten largest stocks that recently represented nearly 34% of the market capitalization of the S&P 500 Index, as well as the equities that we hold in our clients' portfolios, it is clear that these businesses



possess many of the 7 Powers. That said, disparities between market price and intrinsic value can either add to or detract from investment results – valuation discipline is essential.

Ours is a differentiated approach and it is what our clients expect from Sapphire as their fiduciary advisor. We believe that exceptional investment performance can be achieved by limiting the opportunity set to businesses that generate extraordinary operating results purchased at prices that further mitigate the risk of permanent loss. We always have the following attributes in mind:

- Sustainable competitive advantages
- Proven management with the right incentives
- High, sustainable margins
- Free cash flow growth
- High returns on capital
- Attractive reinvestment opportunities
- Financial strength, and
- Reasonable valuation

If our approach to investing appeals to you, please give us a call.

Respectfully,

A handwritten signature in black ink that reads "Paul Stropkay". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Paul Stropkay, CFA

Sources

- *Competitive Advantage* copyright 1985 by Michael E. Porter
- *7 Powers: The Foundations of Business Strategy* copyright 2016 by Hamilton Helmer
- J.P. Morgan Asset Management *Guide to the Markets*® U.S. 2Q 2024 as of March 31, 2024



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