

# Parnassus Mid Cap Fund Commentary

Fourth Quarter 2019

Ticker: Investor Shares - PARMX

Ticker: Institutional Shares - PFPMX

As of December 31, 2019, the net asset value (“NAV”) of the Parnassus Mid Cap Fund – Investor Shares was \$35.63, and after taking dividends into account, the total return for 2019 was 28.75%. This compares to 30.54% for the Russell Midcap Index (“Russell”) and 28.32% for the Lipper Multi-Cap Core Funds Average, which represents the average return of the multi-cap core funds followed by Lipper (“Lipper average”).

Below is a table comparing the Parnassus Mid Cap Fund with the Russell and the Lipper average for the one-, three-, five- and ten-year periods.

## Average Annual Total Returns (%)<sup>1</sup>

	1Y	3Y	5Y	10Y	Gross Expense Ratio	Net Expense Ratio
PARMX	28.75	11.65	9.88	12.76	1.02	0.99
PFPMX	29.02	11.91	10.12	12.89	0.75	0.75
Russell Midcap Index	30.54	12.06	9.33	13.19	–	–
Lipper Multi- Cap Core Funds Average	28.32	12.42	8.91	11.38	–	–

<sup>1</sup>As of December 31, 2019.

\*For this report, we quote total return to the portfolio, which includes price change and dividends.

The average annual total return for the Parnassus Mid Cap Fund – Institutional Shares from commencement (April 30, 2015) was 10.72%. Performance shown prior to the inception of the Institutional Shares reflects the performance of the Parnassus Mid Cap Fund – Investor Shares and includes expenses that are not applicable to and are higher than those of the Institutional Shares. The performance of the Institutional Shares differs from that shown for the Investor Shares to the extent that the classes do not have the same expenses.

**Performance data quoted represent past performance and are no guarantee of future returns. Current performance may be lower or higher than the performance data quoted. Current performance information to the most recent month end is available on the Parnassus website ([www.parnassus.com](http://www.parnassus.com)). Investment return and principal value will fluctuate, so an investor's shares, when redeemed, may be worth more or less than their original principal cost.** Returns shown in the table do not reflect the deduction of taxes a shareholder may pay on fund distributions or redemption of shares. The Russell Midcap Index is an unmanaged index of common stocks, and it is not possible to invest directly in an index. Index figures do not take any expenses, fees or taxes into account, but mutual fund returns do. Mid-cap companies can be more sensitive to changing economic conditions and have fewer financial resources than large-cap companies. As described in the Fund's current prospectus dated May 1, 2019, as Amended and Restated September 16, 2019, Parnassus Investments has contractually agreed to limit total operating expenses to 0.99% of net assets for the Parnassus Mid Cap Fund – Investor Shares and to 0.77% of net assets for the Parnassus Mid Cap Fund – Institutional Shares. This agreement will not be terminated prior to May 1, 2020, and may be continued indefinitely by the Adviser on a year-to-year basis.



## Year in Review

The Russell Midcap Index posted four consecutive quarterly gains in 2019 for a total return above 30%. Despite generally anemic earnings growth and trade-war noise, investors focused on the Federal Reserve's easing cycle and generally positive economic news to drive stocks to a record high. This return was the largest since 2013 and caps a record-long bull market for U.S. equities.

The Parnassus Mid Cap Fund – Investor shares had a 28.75% return, which captured more than 94% of the Russell's gain. The Fund's return beat our Lipper peers' 28.32% gain. The Fund's year-to-date performance was ahead of the Russell heading into the fourth quarter, but fell behind when the information technology sector, an area where we are defensively positioned, rallied more than 11%. We're never excited to underperform the market, but considering the Fund's focus on downside risk, we are tolerant of this high level of upside capture.

From a sector allocation perspective, the fund benefited from being underweight relative to the Russell in the energy sector, the worst-performing

sector in the benchmark, and being overweight relative to the Russell in the industrials sector, the second-best performing sector in the benchmark. These allocations increased the Fund's return relative to the Russell by 63 and 23 basis points, respectively. (One basis point is 1/100th of one percent.) Our overweight position relative to the Russell in the consumer staples sector hurt the Fund the most, subtracting 34 basis points from the Fund's return.

The Fund's weakest performer was National Oilwell Varco, a global supplier of oilfield equipment and technology. The stock subtracted 28 basis points from the Fund's return, as its total return from our average cost was negative 35.9%.\* We sold our position in the third quarter after the company reported steep order declines for its oilfield equipment and significantly lower earnings guidance. As we re-evaluated our thesis on the stock, we became concerned about declining relevancy of the company's products as the global economy continues to decarbonize and shift toward renewable fuel sources and electric transportation. Following our exit of the stock, Parnassus adopted a firm-wide fossil fuel free policy, which means that our funds will avoid investing in companies that derive significant revenues from the extraction, exploration, production or refining of fossil fuels.

#### Ten Largest Holdings<sup>2,3</sup>

US Foods Holding Corp.	4.4%
Hologic Inc.	4.1%
Teleflex Inc.	3.8%
Motorola Solutions Inc.	3.6%
Cerner Corp.	3.4%
Republic Services Inc.	3.3%
Pentair plc	3.2%
Jack Henry & Associates Inc.	3.2%
Trimble Inc.	3.1%
Burlington Stores	3.1%
<b>Total</b>	<b>35.2%</b>

<sup>2</sup>As of December 31, 2019.

<sup>3</sup>As a percentage of total net assets.

Holdings and allocations are subject to change.

Americold Realty Trust, one of the largest cold storage providers, subtracted 17 basis points from the Fund's return as its total return from our average cost was negative 6.5%. The company missed earnings estimates in the most recent quarter due to higher-than-expected employee health care costs and new development start-up costs. We view the pullback as temporary and believe the company is uniquely positioned with its mission-critical cold storage assets and multi-year contracts. The company is also positioned as an industry consolidator and has a healthy acquisition pipeline. Coupled with management's focus on operating efficiency, we believe this should drive durable revenue growth and margin expansion over the long term.

IDACORP, Inc., the largest electric utility in Idaho, subtracted four basis points from the Fund's return, as its total return was negative 0.94%. Although the company reported stronger-than-expected earnings results, raised its full-year earnings guidance and upped its dividend payout ratio in the fourth quarter of 2019, investors soured on the utility sector, causing IDA's earnings multiple to contract. Despite the sentiment change, we believe the company has attractive earnings prospects, as it benefits from a favorable regulatory environment, robust pipeline of renewable energy projects and positive demographic trends in Idaho.

Shifting to our winners, our strongest performer was Motorola Solutions, the largest provider of mission-critical communications solutions. The stock added 185 basis points to the Fund's return, as its total return was 42.2%. The stock jumped in early 2019 after the company provided an EPS target of \$10 in 2021, which was 12% higher than investors' expectations. The shares continued to move higher as the company's quarterly financial results consistently beat expectations. Motorola's dominant land mobile radio business is a ballast for its product portfolio, while its software, services and video offerings are growing rapidly as customers are attracted by Motorola's integrated, cost-effective and innovative product offerings.

Leading medical device manufacturer Teleflex added 174 basis points to the fund's return, as its total return was 46.3%. The stock rose early in 2019, as the company saw stronger-than-expected demand for its leading, non-invasive UroLift solution for benign prostatic hyperplasia and its portfolio of minimally invasive products for coronary and peripheral vascular diseases. Sales momentum continued throughout the year, driven by the strength of recent acquisitions in the vascular and urology segments and robust international demand. Investors became more bullish on the stock after the company raised its revenue outlook in the third quarter to 7.5-8.0% from its annual guidance of 6.0-7.0% at the beginning of the year. We remain excited about the company's long-term prospects, as it benefits from increasing adoption of its urology and vascular products, additional margin expansion and strong free cash flow generation.

Our third big winner was Fiserv, a leading provider of financial services technology and core processing software used by banks. The stock added 131 basis points to the Fund's return, as the total return from our average cost of its shares was 84.2%. The stock rose early in the year after management provided a positive earnings outlook, driven by strong demand for its core systems, digital offerings and peer-to-peer payment solutions. Investors became even more bullish mid-year after the company completed its merger with First Data Corporation. After enjoying gains resulting from the transaction, we exited the stock in the third quarter as Fiserv's market capitalization rose above \$70 billion following the deal closure.

### Outlook and Strategy

The Russell's bull run is just a few months away from celebrating its 11th anniversary. This is the longest bull market in many decades. On the positive side, the domestic economy is still healthy by most measures, inflation remains in check, the global economy is showing signs of life, a trade truce could be on the horizon and the Fed's accommodative policy is giving investors comfort. However, uncertainty related to international and domestic political and economic conflicts, economic concerns in China, rising consumer and corporate debt in the U.S., a growing federal

### Sector Weighting<sup>4,5</sup>

	● PARMX	● Russell Midcap Index
Industrials	18%	14%
Information Technology	17%	18%
Health Care	14%	10%
Consumer Staples	10%	4%
Financials	10%	13%
Real Estate	10%	9%
Consumer Discretionary	9%	12%
Utilities	6%	7%
Communication Services	2%	4%
Materials	2%	5%
Energy	0%	4%
Short-Term Investments	2%	0%

<sup>4</sup>As of December 31, 2019.

<sup>5</sup>As a percentage of total net assets.

budget deficit and slowing corporate earnings growth temper our optimism.

One of our larger concerns is stock valuation. At year end, the Russell traded at more than 20 times forward earnings estimates, a materially higher multiple than the 20-year average of 17 times. Further, much of the rise in stock prices during the past year was driven by multiple expansion rather than earnings growth. It's difficult to predict whether this issue, as well as the concerns mentioned above, will result in a significant market correction, but we believe the market's downside risk has increased. As a result, we remain focused on our strategy of owning a collection of high-quality businesses that we believe offer longer-term asymmetric risk-reward opportunities.

The Fund is defensively positioned heading into 2020. We are underweight relative to the Russell in the consumer discretionary, financials, materials and information technology sectors, which we feel are likely to underperform in a market correction.

We are overweight relative to the Russell in the consumer staples, health care and real estate sectors, which should prove to be resilient in a market sell-off. We are overweight relative to the Russell in the generally cyclical industrials sector, but as discussed in the past, many of our positions in this area are less-

cyclical business service-style companies. Positions such as Republic Services and Verisk Analytics serve as a portfolio ballast, because these companies provide mission-critical services that are supported by significant recurring revenue and long-term contracts. Our traditional industrial exposure is through Fortive, Xylem and Pentair, which have strong secular tailwinds, such as a decade-long replacement cycle for water technology and infrastructure. We believe this overall sector positioning may serve us well in any market condition, but especially in the event of a downturn.

We added only one new stock in the recent quarter. We initiated a position in Americold Realty Trust, one of the largest cold storage providers for food producers, distributors and retailers. The company is well-positioned to capture potential outsized market share gains with its mission-critical temperature-controlled storage facilities, as they are increasingly integrated into its customers' supply chains. We were also attracted by Americold's defensive business model, which is supported by multi-year contracts and highly sticky customer relationships. We believe the company has a long runway for earnings growth, as the company benefits from industry consolidation, operational efficiency gains and strong secular tailwinds.

During the quarter, we exited our position in document storage provider Iron Mountain, primarily due to our concerns about long-term secular pressures on its document storage business and increasing competition in its wholesale data center business.

We're pleased that our strategy has provided excellent long-term, risk-adjusted results to shareholders. Our upside capture percentage is healthy, especially relative to the Fund's risk profile. We're especially pleased that in the down-market years during our portfolio management tenure—2008, 2011, 2015 and 2018—the Fund handily beat its benchmarks. We will continue to focus on owning responsible, well-managed, increasingly relevant businesses with sustainable

competitive advantages. We are confident that this strategy will help the Fund outperform the market over the long term.

Thank you for your investment in the Parnassus Mid Cap Fund.

Yours truly,



Matthew D. Gershuny

Portfolio Manager



Lori A. Keith

Portfolio Manager

**Price/Earnings (P/E) Ratio** is a ratio of a stock's current price to its per-share earnings over the past 12 months (or "trailing" 12 months). Mutual fund investing involves risk, and loss of principal is possible. 0174-012320.

The Parnassus Funds are distributed by Parnassus Funds Distributor, LLC.

**Before investing, an investor should carefully consider the investment objectives, risks, charges and expenses of a fund and should carefully read the prospectus or summary prospectus, which contain this and other information. The prospectus or summary prospectus can be found on the website, [www.parnassus.com](http://www.parnassus.com), or by calling (800) 999-3505.**