PARNASSUS INVESTMENTS®

Parnassus Mid Cap Fund Commentary

Fourth Quarter 2018

Ticker: Investor Shares - PARMX
Ticker: Institutional Shares - PFPMX

As of December 31, 2018, the net asset value ("NAV") of the Parnassus Mid Cap Fund – Investor Shares was $28.86, and after taking dividends into account, the total return for 2018 was a loss of 6.64%. This compares to a loss of 9.06% for the Russell Midcap Index ("Russell") and a loss of 7.88% for the Lipper Multi-Cap Core Funds Average, which represents the average return of the multi-cap core funds followed by Lipper ("Lipper average"). For the quarter, the Fund was down 11.18%, less than the Russell's 15.37% loss and the Lipper average's 14.41% loss.

Average Annual Total Returns (%)[1]

	1Y	3Y	5Y	10Y	Gross Expense Ratio	Net Expense Ratio
PARMX	-6.64	7.86	6.71	13.40	1.01	0.99
PFPMX	-6.39	8.10	6.89	13.50	0.75	0.75
Russell Midcap Index	-9.06	7.04	6.26	14.03	–	–
Lipper Multi-Cap Core Funds Average	-7.88	6.58	5.52	11.61	–	–

[1]As of December 31, 2018.
The average annual total return for the Parnassus Mid Cap Fund–Institutional Shares from commencement (April 30, 2015) was 6.20%. 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 represents 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). 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, 2018, 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 0.85% of net assets for the Parnassus Mid Cap Fund-Institutional Shares. This agreement will not be terminated prior to May 1, 2019, and may be continued indefinitely by the Adviser on a year-to-year basis. The net expense ratio is what investors pay.

To the left 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. The Fund's long-term track record remains very good, and we're pleased to report that the Fund outperformed both of its benchmarks in nearly all the listed periods.

Year in Review

The Russell Midcap Index dropped more than 9.1% in 2018, but this result doesn't tell the whole story. Mid-cap stocks rose almost 7.6% through the middle of September, as investors focused on positive news such as the strong domestic economy and robust earnings growth boosted by the corporate tax cut. Sentiment turned sour shortly afterward, when investors became fixated on threats from rising interest rates, domestic political pageantry and the trade war with China. The sell-off was steep and fast, with mid-cap stocks falling an astonishing 17% from peak to trough. While we are never happy to report a loss, the silver lining is that for the year, the Fund outperformed the Russell by 242 basis points and the Lipper average by 124 basis points. (One basis point is 1/100th of one percent.)

From a sector-allocation perspective, the Fund benefitted from being underweight relative to the Russell Index in the energy and financial sectors, two of the worst-performing sectors in the benchmark. These allocations increased the Fund's return relative to the Russell by 36 and 33 basis points, respectively. Our underweight position relative to the Russell in the information technology sector hurt the Fund the most, subtracting 44 basis points from the Fund's return. Our overweight position relative to the Russell in the materials sector also hurt, cutting 32 basis points from the Fund's return.

As usual, the primary driver of the Fund's performance was stock selection rather than sector allocation. The Fund's health care and financial stock selection hurt performance relative to the Russell by 157 and 100 basis points, respectively. Conversely, strong stock selection in industrials and the information technology sectors helped the Fund's performance relative to the Russell by 295 and 200 basis points, respectively.

The Fund's weakest performer was First Horizon National, a Tennessee-based regional bank. The stock subtracted 134 basis points from the Fund's return, as its shares yielded a total negative return of 32.3%. (For this report, we will quote total return to the portfolio, which includes price change and dividends.) The shares fell after loan growth came in below expectations, as the integration of its recently completed acquisition of Capital Bank took longer than expected. First Horizon shares were also under pressure throughout the year, along with other bank stocks, as investors worried that the flattening yield curve would reduce net interest revenues and could portend a recession, which would increase credit losses. With the integration of Capital Bank now complete, we expect loan growth to accelerate in 2019. We continue to like First Horizon's dominant position in Tennessee, its diversified, low-risk loan book, its exposure to growth markets in the Carolinas and South Florida and its cheap valuation.

Ten Largest Holdings[2,3]

Teleflex Inc.	4.5%
Hologic Inc.	4.4%
Motorola Solutions Inc.	4.3%
Fiserv Inc.	3.8%
First Horizon Ntl. Corp.	3.7%
Xylem Inc.	3.7%
Verisk Analytics Inc.	3.4%
The Clorox Company	3.2%
Trimble Inc.	3.1%
Sempra Energy	3.0%
Total	**37.1%**

[2]As of December 31, 2018.
[3]As a percentage of total net assets.

Dentsply Sirona, one of the largest manufacturers of dental equipment and consumables, subtracted 123 basis points from the Fund's return, as the total return of its stock was negative 43.0% for the year. The stock fell throughout the year because revenue growth repeatedly missed investors' expectations. The company's equipment business was hurt by material destocking headwinds, especially in the second half of 2018. Management unveiled a restructuring plan in late 2018, aiming to simplify the business, reduce duplicate facility costs and boost operating margins. We believe the stock is now attractively valued relative to expectations, and we see upside ahead if management can successfully execute its restructuring plan and deliver higher revenue growth through product innovation and improved sales effectiveness.

Hanesbrands, a leading manufacturer of undergarments and athletic apparel, reduced the Fund's return by 114 basis points, as its stock posted a 38.0% loss. Retail store bankruptcies and inventory reductions by key customers such as Walmart and Target led to sluggish demand for its basics and innerwear products in the United States. Target also announced that it is discontinuing Hanes's C9 Champion apparel brand when the exclusive contract ends in January 2020. Despite the lost future revenue, management remains confident in the long-term potential of the global Champion brand, which continues to grow revenue by double-digit percentages in all regions. Within the challenging intimates category, management is introducing new product designs and innovations, which is helping to stabilize this business after multiple quarters of decline.

Our biggest winner was Motorola Solutions, the largest provider of mission-critical communications solutions. The stock added 99 basis points to the Fund's return, as its total return was 29.6%. The stock moved higher as the company raised its 2018 earnings guidance three times over the year due to broad-based demand for land mobile radio systems and surveillance solutions from Avigilon, a recent acquisition. Motorola is winning market share and expanding its addressable markets by providing the most innovative and complete communications solutions to its public safety and corporate clients.

McCormick, the herb and spice seasonings company, contributed 79 basis points to the Fund's return, as the total return of its shares was 39.0%. The stock moved higher as the company benefited from healthy demand following distribution gains and increased brand marketing. The acquisition a year ago of Frank's RedHot sauces and French's condiments also contributed to the strong performance because these brands saw accelerated growth. Management also noted that this strong momentum should continue through strengthening distribution, product innovation, improved category management and brand marketing investments.

Integrated Device Technology, Inc., a leading provider of high-performance analog mixed-signal solutions, contributed 54 basis points to the Fund's return, as the total return of its shares was 58.4%. The stock rose in the summer after the company delivered better-than-expected earnings. The shares jumped again after the company announced an agreement with Renesas Electronic Corporation, which will be acquired for $49 per share in an all-cash transaction.

Outlook and Strategy

After a nearly ten-year bull market, the Russell tumbled sharply in late 2018. The economy is still healthy by most measures and inflation remains in check, but the same issues that plagued the market starting at the end of the third quarter of 2018 persist as we enter 2019. The overall theme is fear of a slowing global economy, but specific concerns include uncertainty related to international and domestic political and economic conflicts, economic weakness in China and emerging markets, rising consumer and corporate leverage, the high federal budget deficit, rising interest rates and slowing corporate earnings growth. It's difficult to predict whether these concerns will abate or deepen, but it's fair to say that there are more moving parts than there have been for a while.

At year end, following the recent market rout, the Russell traded at about 14 times forward earnings estimates, a materially lower multiple than the 18 times we saw at this time last year and below the 20-year average of 16 times. Stocks are cheaper than they have been in a while, which is creating select buying opportunities. At the same time, for many stocks the range of outcomes has widened and expected earnings growth is less certain given the risks mentioned above. As a result, we are sticking to our knitting, focusing on maintaining a portfolio of individual businesses that we believe offer longer-term asymmetric risk-reward opportunities.

Sector Weighting[4,5]

Sector	PARMX	Russell Midcap Index
Communication Services	4%	3%
Consumer Discretionary	7%	13%
Consumer Staples	8%	4%
Energy	2%	5%
Financials	9%	13%
Health Care	13%	10%
Industrials	18%	13%
Information Technology	18%	18%
Materials	4%	5%
Real Estate	6%	9%
Utilities	6%	7%
Short Term Investments	5%	0%

[4]As of December 31, 2018.
[5]As a percentage of total net assets.

We took advantage of the recent market weakness to add to many of our high-quality positions as well as buy some new stocks. We initiated a position in Digital Realty, a real estate company that owns scarce datacenter properties in attractive markets. The stock pulled back when the company announced an equity sale to fund development and growth. Investors also worried about a spending slowdown by their largest customers. We believe these are short-term concerns, and that Digital's assets are becoming increasingly relevant as enterprises move applications to the cloud and connectivity demands increase due to the emergence of the Internet of Things and artificial intelligence. Finally, the company has a strong competitive moat supported by global scale and high switching costs for its tenants.

We also initiated a position in Cerner, the largest publicly traded healthcare information technology company. Cerner has a dominant market position providing a wide range of software, hardware and services, which are used across hospitals, pharmacies and physician practices. Cerner's core product, electronic medical records, operates in a duopoly, and nearly two-thirds of the company's revenue is recurring. The company recently signed a 10-year, $10 billion contract with the United States Department of Veterans Affairs, the largest health system in the world. Going forward, we believe the company has several exciting growth opportunities and the ability to expand margins.

Reflecting our bottom-up process, the Fund currently has a 27% weighting in the less-cyclical consumer staples, health care and utilities sectors, as compared to 21% for the Russell. Our exposure to the more cyclical financials, consumer discretionary and energy sectors is 18%, which is well below the Russell's 30% weighting. We continue to own slightly more industrial stocks than the benchmark. Within this sector, we own innovative companies in growing markets such as Xylem and Fortive, along with several business service companies with significant recurring revenue, such as Verisk Analytics. This positioning, which isn't too different from past years, should enable the Fund to do well in many different market environments, especially in the event of further weakness.

We're pleased that our strategy is providing good long-term results to shareholders. We're especially pleased that in the down-market years over the last decade—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, by participating in up-markets, providing down-market outperformance and avoiding permanent capital losses.

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

Yours truly,

Matthew D. Gershuny	Lori A. Keith
Lead Portfolio Manager	Portfolio Manager

Mutual Fund investing involves risk, and loss of principal is possible.

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