

Quality Dynamics

The Lead | January 2025

Performance by S&P Stock Quality Rating

Quality Indices	1 M	3 M	6 M	12 M	YTD
A+	-7.11	-5.08	3.51	6.37	6.37
A	-6.31	-2.20	7.78	8.65	8.65
A-	-7.64	-4.45	5.26	8.12	8.12
B+	-6.46	-3.08	6.00	8.61	8.61
B	-6.83	-1.36	5.80	7.61	7.61
B-	-4.52	0.53	6.56	5.65	5.65
C&D	-7.55	-1.31	9.93	10.91	10.91
Not Ranked	-7.25	1.84	8.79	27.18	27.18
B+ or Better	-6.76	-3.39	5.96	8.79	8.79
B or Worse	-6.72	0.73	7.96	19.29	19.29

Sources: BofA Global; Sterling Capital.

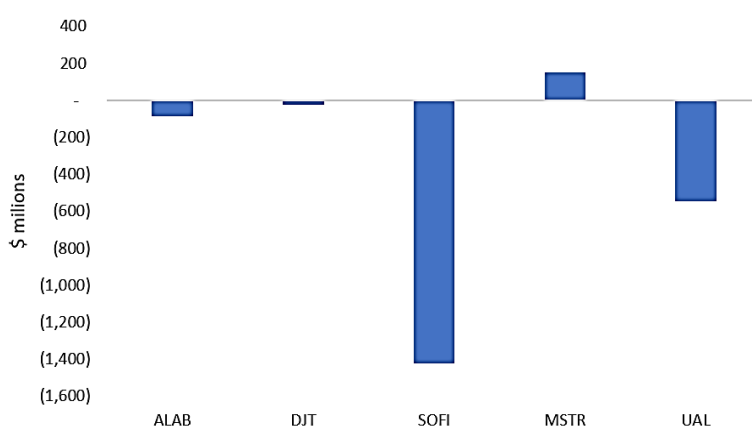
The fourth quarter of 2024 started with a bang but ended in a whimper for the market, in our view. One of the most interesting dynamics to us was the relative underperformance of value stocks compared to the overall market and the nature of the performance. For context, the Russell 1000® Value Index was down -2.0% on a total return basis while the S&P 500® Index was up +2.4%.

We believe the other interesting component was the nature of what stocks worked in both indices. The table above shows the performance in 4Q24 and 2024 for stocks based on S&P quality measures that include return on equity (ROE) and balance sheet leverage, with higher-quality stocks receiving higher letter grades. The table shows in the bottom two lines how low-quality stocks with B or worse ratings outperformed higher-quality stocks of B+ or better by +4.12% for the quarter and +10.50% for the year.

This dynamic appears to be confirmed by the top five absolute performers in the Russell 1000 Value during the quarter, seen in the chart to the right. Over the past three calendar years, this group of stocks earned a profit in only 20% of those years.

Only the cryptocurrency-focused stock, Microstrategy, generated a profit, while cumulatively they lost money over those years. With unprofitable companies constituting the top performers in the Russell 1000 Value, we believe it provides confirmation for the Bank of America Global research that low-quality stocks performed well in the most recent quarter.

Top 4Q24 Absolute Performers Net Income 2021-2023



Source: Bloomberg L.P. Stock tickers are for Astera Labs, Trump Media, Sofi, Microstrategy, and United Airlines.

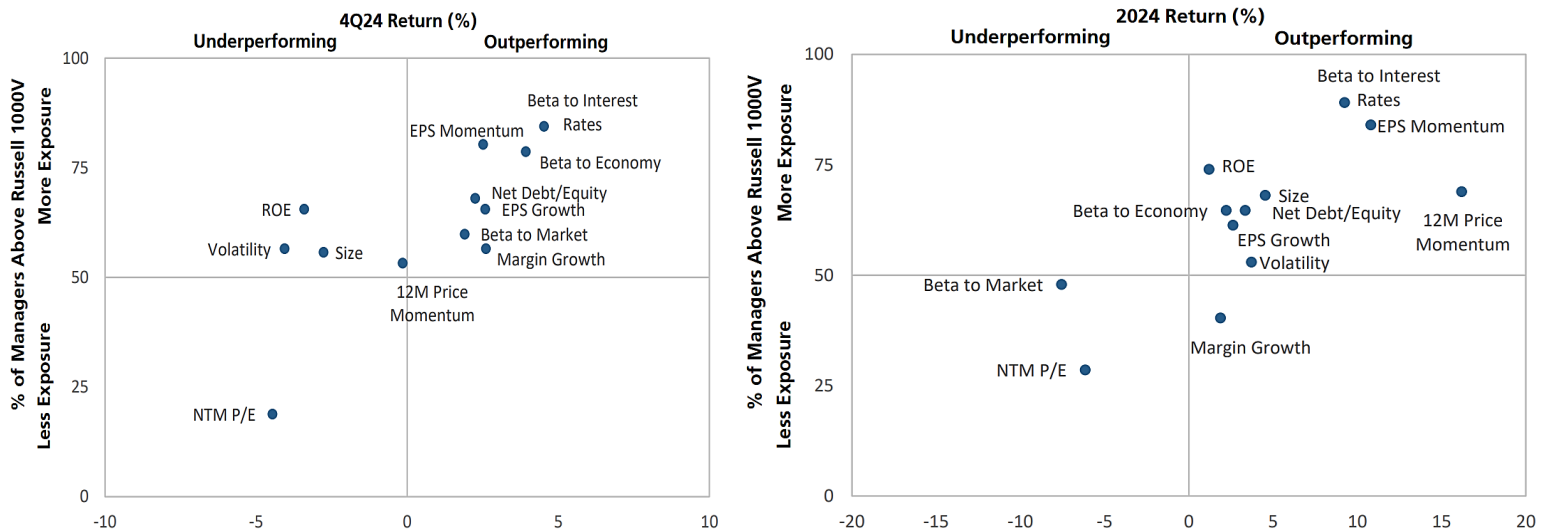
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Characteristics Performance Large Cap Value Peer Group



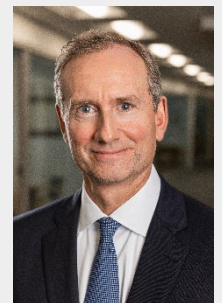
Source: UBS. EPS: earnings per share. NTM: next twelve months. P/E: price-to-earnings ratio.

On the charts above, we show what worked in the large cap value space relative to the peer group rather than the index. These charts for Q4 and 2024 appear to show a similar story. What worked in the upper right quadrant was momentum, whether it was price or earnings, managers willing to own stocks with risk related to interest rates, the macroeconomy, or higher balance sheet leverage.

While quarter-to-quarter and occasionally year-to-year certain characteristics may come in and out of favor, we have found that our focus on quality companies with strong balance sheets, earnings growth, and attractive valuations may position clients for success in the long term.

As always, thank you for your interest and trust managing your investments.

Charles J. Wittmann, CFA®, Executive Director, joined Sterling Capital Management in 2014 and has investment experience since 1995. Chip is Co-Portfolio Manager of the Equity Income strategy. Prior to joining Sterling, he worked for Thompson Siegel & Walmsley as a portfolio manager and (generalist) analyst. Prior to TS&W, he was a founding portfolio manager and analyst with Shockoe Capital, an equity long/short hedge fund. Chip received his B.A. in Economics from Davidson College and his M.B.A. from Duke University's Fuqua School of Business. He holds the Chartered Financial Analyst® designation and served as President of CFA Society Virginia from 2012-2013.



Past performance is not indicative of future results. Any type of investing involves risk and there are no guarantees that these methods will be successful. Charts are for illustrative purposes only.

Important Information

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The volatility of an index varies greatly. All indices are unmanaged and investments cannot be made directly in an index.

The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values. The Russell 1000® Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.

The S&P 500® Index is a readily available, carefully constructed, market-value-weighted benchmark of common stock performance. Currently, the S&P 500 Composite includes 500 of the largest stocks (in terms of stock market value) in the United States and covers approximately 80% of available market capitalization.

Dividend-focused strategies may underperform strategies that do not limit their investment to dividend-paying stocks. Stocks held strategy may reduce or stop paying dividends, affecting the strategy's ability to generate income.

Technical Terms: **Earnings per share (EPS)** is a measure of a company's profitability that indicates how much profit each outstanding share of common stock has earned. It's calculated by dividing the company's net income by the total number of outstanding shares. **The price-to-earnings (P/E) ratio** measures a company's share price relative to its earnings per share (EPS). Often called the price or earnings multiple, the P/E ratio helps assess the relative value of a company's stock. **Return on equity (ROE)** is a measure of a company's financial performance. It is calculated by dividing net income by shareholders' equity. (Technical definitions are sourced from Corporate Finance Institute and Investopedia.)

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Since we began publishing The Lead in 2015, our primary purpose has been to communicate our investment philosophy and process as an investment advisor in the context of changing markets. In creating portfolios that differ from our benchmarks by focusing on characteristics that have a long term history of attractive relative returns according to Ned Davis Research, the portfolios are different from the benchmarks and as a result there can be periods where results differ including below benchmark performance. Since strategies are oriented toward the long term characteristics, if those characteristics are out of favor over a period of time, the given strategy's performance could be challenged in terms of relative performance. While Sterling believes active professional investment management that employs a consistent process with a long term orientation and aligned with client interests offers benefits, management fees to support the active approach can be higher than certain alternatives. When hiring an investment manager we believe it is important to monitor the investment risks taken including sector concentrations, portfolio turnover, and the impacts of dividend policy changes.