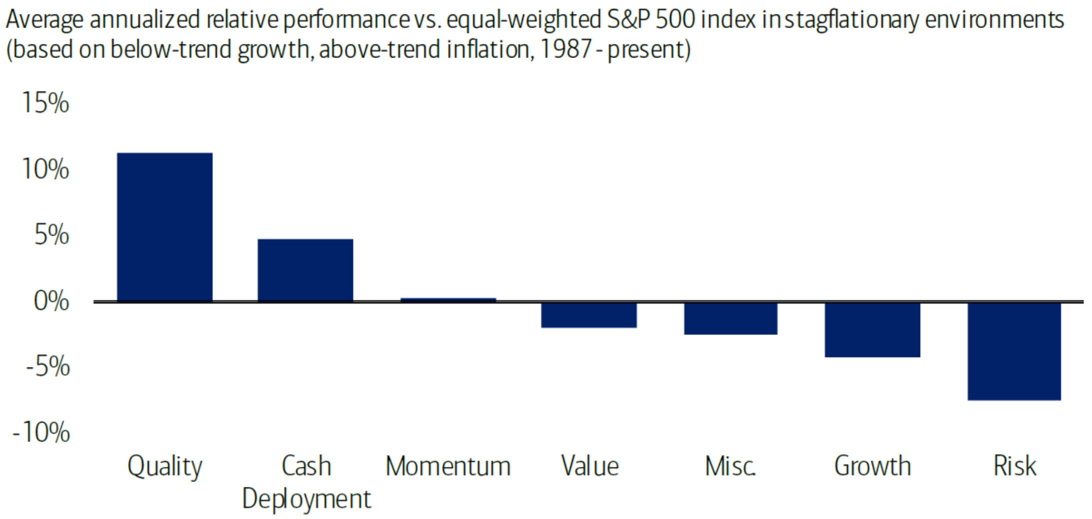
Going for Gold

The Lead | July 2024

Quality, Dividends, and Share Repurchases Perform Well During Stagflationary Periods



Source: BofA Global Research.

The only road running event in the Olympics is the marathon, which has been present since the first program in 1896. It was inspired by an Ancient Greek messenger who was said to run from Marathon to Athens to announce a Greek victory over Persia. What is less known is the hilly nature of the course, with a continuous uphill run from miles 11 to 19. Marathon runners train and fortify themselves to meet the challenges when the course is uphill.

Investing can be similar to running a marathon as one may question if one is prepared for more challenging times. Economic indicators such as gross domestic product (GDP) and the Institute for Supply Management (ISM) Manufacturing Index recently showed slowing growth, while the Consumer Price Index (CPI) remains stubbornly above the Federal Reserve (Fed)'s target rate. Concerns over slowing economic growth amidst higher inflation, also known as stagflation, have emerged.

In such a scenario, we would note the two charts on this page from Bank of America. The top chart shows that quality and cash deployment (dividends and share buybacks) shine in a slow growth, higher inflation environment. Moreover, those companies that are providing more value in the present than promised in the future (short duration) can be found in the large value segment of the market, shown in the upper left box in the chart below.

Duration Risk by Index

	Value	Core	Growth
Large	**Shortest duration:** LTG: 9% Div. payout: 36% FCF/EV: 4% % of non-earners: 5%	LTG: 12% Div. payout: 31% FCF/EV: 3% % of non-earners: 6%	LTG: 14% Div. payout: 24% FCF/EV: 3% % of non-earners: 7%
Mid	LTG: 11% Div. payout: 30% FCF/EV: 3% % of non-earners: 6%	LTG: 11% Div. payout: 29% FCF/EV: 3% % of non-earners: 7%	LTG: 11% Div. payout: 22% FCF/EV: 3% % of non-earners: 9%
Small	LTG: 10% Div. payout: 47% FCF/EV: 3% % of non-earners: 32%	LTG: 12% Div. payout: 42% FCF/EV: 2% % of non-earners: 32%	**Longest duration:** LTG: 17% Div. payout: 33% FCF/EV: 1% % of non-earners: 36%

Highest Duration Risk →

Highest Duration Risk ↓

LTG: long-term growth. FCF/EV: free cash flow/enterprise value.
Source: BofA Global Research.

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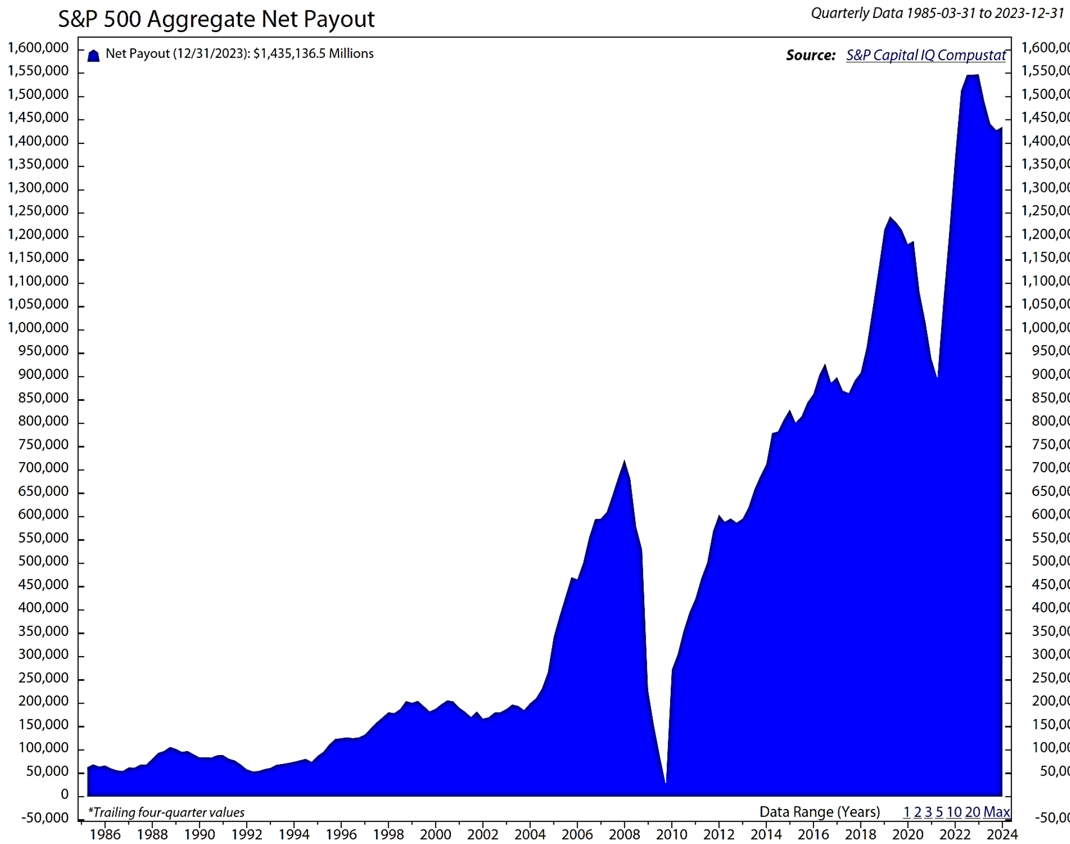
Net Payout (Dividends and Buybacks) down 7% in 2023



Source: Ned Davis Research.

The problem recently is that the slowing economy has led to a slowdown in cash returned to shareholders in the form of dividends and share buybacks by the market. We believe in the importance of preparation for potential uphill climbs as well as the value in scarcity. At present, we believe that finding companies that are not slowing their dividends and share repurchases is rare. We would note that as of 2Q24, the Sterling Capital Equity Income strategy's holdings have increased their dividends by over 15% and reduced their share count by over -1% year-over-year. It is our goal that our client portfolios are positioned to finish strong regardless of the conditions.

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.

Important Information

Disclosures

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. Economic charts are provided for illustrative purposes only. The information provided herein is subject to market conditions and is therefore expected to fluctuate.

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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 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.

Dividend Growing, No-Change-in-Dividend, and Dividend Cutting: Each dividend-paying stock is further classified into one of the three categories based on changes to their dividend policy over the previous 12 months. Dividend Growers and Initiators include stocks that increased their dividend anytime in the last 12 months. Once an increase occurs, it remains classified as a grower for 12 months or until another change in dividend policy. No-Change stocks are those that maintained their existing indicated annual dividend for the last 12 months (i.e., companies that have a static, non-zero dividend). Dividend Cutters and Eliminators are companies that have lowered or eliminated their dividend anytime in the last 12 months. Once a decrease occurs, it remains classified as a cutter for 12 months or until another change in dividend policy. (Source: Ned Davis Research).

Technical Terms: **The Consumer Price Index (CPI)** measures the monthly change in prices paid by U.S. consumers. The Bureau of Labor Statistics (BLS) calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending. **Dividend Risk:** Dividend yield is one component of performance and should not be the only consideration for investment. Dividends are not guaranteed and will fluctuate. This report should not be regarded by the recipients as a substitute for the exercise of their own judgment. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager. **Dividend Yield**: a financial ratio that measures the annual value of dividends received relative to the market value per share of a security. In other words, the dividend yield formula calculates the percentage of a company’s market price of a share that is paid to shareholders in the form of dividends. **The EV/FCF ratio** compares a company's enterprise value (EV) to its free cash flow (FCF). This valuation ratio provides an overview of a company's total value, encompassing both equity and debt, in relation to its available cash flow. **Gross domestic product (GDP)** is the total monetary or market value of all the finished goods and services produced within a country’s borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of a given country’s economic health. (Technical definitions are sourced from Corporate Finance Institute and Investopedia.)

The **Chartered Financial Analyst® (CFA)** charter is a graduate-level investment credential awarded by CFA Institute — the largest global association of investment professionals. To earn the CFA charter, candidates must: 1) pass three sequential, six-hour examinations; 2) have at least four years of qualified professional investment experience; 3) join CFA Institute as members; and 4) commit to abide by, and annually reaffirm, their adherence to the CFA Institute Code of Ethics and Standards of Professional Conduct.

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.

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