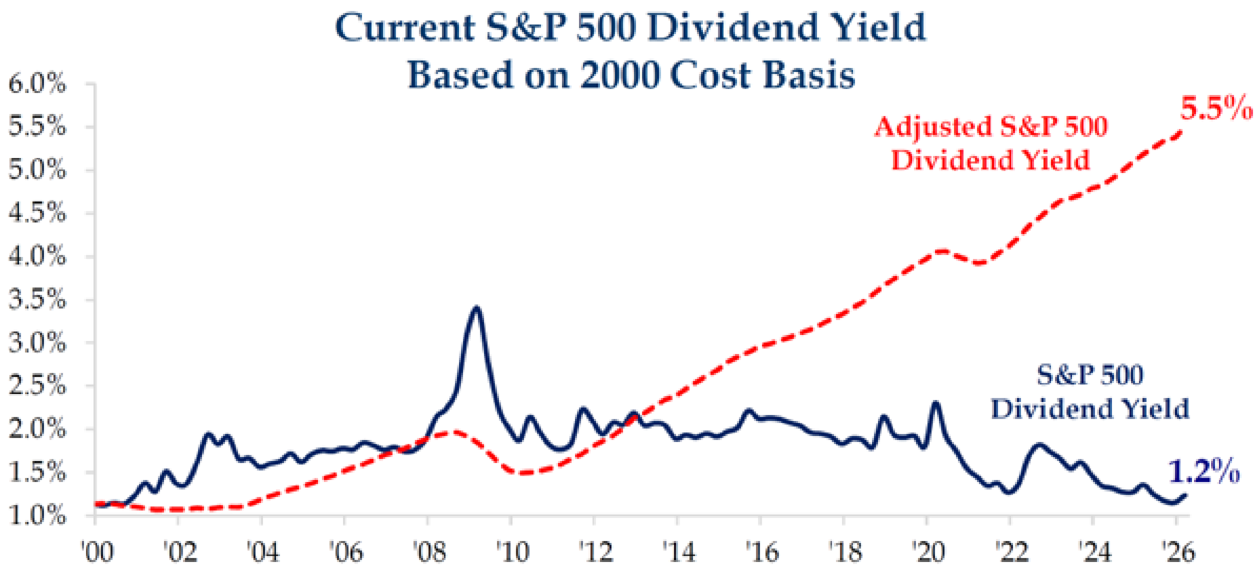
Case for Compounding

The Lead | July 2026



Dividend yield is a financial metric that indicates how much a company pays out in dividends each year relative to its current stock price. Expressed as a percentage, it measures the rate of return you earn purely from cash payouts rather than from the stock's growth. Cost basis is the original cost of obtaining an asset. It can include the purchase price and any fees. Data is as of 03.31.2026. Sources: Strategas; S&P Dow Jones Indices.

Coming off what we believe to be an historic quarter for momentum, it is helpful to keep in mind two very important benefits of investing in equities. One is the power of compounding value over time, and second is the benefit of diversification to generate attractive risk adjusted returns.

In the current market, traditional characteristics of classic long-term investing, such as sustainable earnings growth and its potential byproduct of paying increasingly higher dividends over time, seem to us to have been pushed to the side. While dividend yield appears to be in short supply in the current market, the potential benefits of compounding dividends over time remain significant as seen in the graphic at the top of the page.

Similar to other periods in market history, sectors of the market that have historically demonstrated high returns on capital, strong balance sheets and earnings stability, possibly due to their advantaged competitive positions, have seen their relative market capitalizations shrink. This group now represents the smallest share of the market in its history.

We see this dynamic as potential opportunity. The chart on the next page shows the relative valuation for low volatility stocks that tend to have the characteristics we just outlined. Historically, as the line in blue shows, these stocks typically trade at a premium because of their attractive fundamental characteristics. But it appears not in this market, as they are trading at a historic discount.

S&P 500 Market Factors Performance Over Time

Weekly data 01.11.1985 to 06.26.2026. Source: Ned Davis Research.

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.

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S&P 500 Low Volatility Index vs S&P 500 – P/E Valuation (2011-2026)

P/E: Price to earnings. Trailing P/E is a financial metric that shows the relationship between a company's current share price and its earnings per share over the past year, providing investors with a retrospective valuation measure. The relative P/E ratio compares a stock's standalone (absolute) P/E ratio to a baseline, such as its historical P/E average, an industry benchmark, or a broader market index like the S&P 500. It helps investors quickly determine if a stock is cheap or expensive relative to its peers or its own trading history. Data is as of 06.25.2026. Source: Bloomberg L.P.

While strong fundamentals and market positions coupled with the prospects for growing earnings through more efficient operations sound attractive, in our opinion, the reason for our pursuit of these opportunities lies in their historical track record for generating outperformance over time. The second chart on the first page shows the performance of earnings stability, its performance over the past year and its long- term performance pattern. Our constructive outlook is tempered with an awareness of elevated inflation and low unemployment, which may challenge the prospect of lower rates and leave the door open for a higher federal funds rate, especially with continued strong gross domestic product (GDP) growth.

We also remain mindful of overall valuations that imply elevated expectations and the current market concentration within major market indices.

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

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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 stock market index weighted by market capitalization that is made up of 500 of the largest public companies in the U.S.

The **S&P 500® Low Volatility Index** measures performance of the 100 least volatile stocks in the S&P 500. The index benchmarks low volatility or low variance strategies for the U.S. stock market.

Technical Terms: **Federal funds (Fed funds) rate** is the target interest rate range at which commercial banks and credit unions borrow and lend their reserve balances to each other overnight. Set by the Federal Reserve's Federal Open Market Committee (FOMC), it serves as the foundational benchmark for all other borrowing and lending rates in the U.S. **The gross domestic product (GDP)** is the monetary value of all finished goods and services made within a country during a specific period. (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.

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