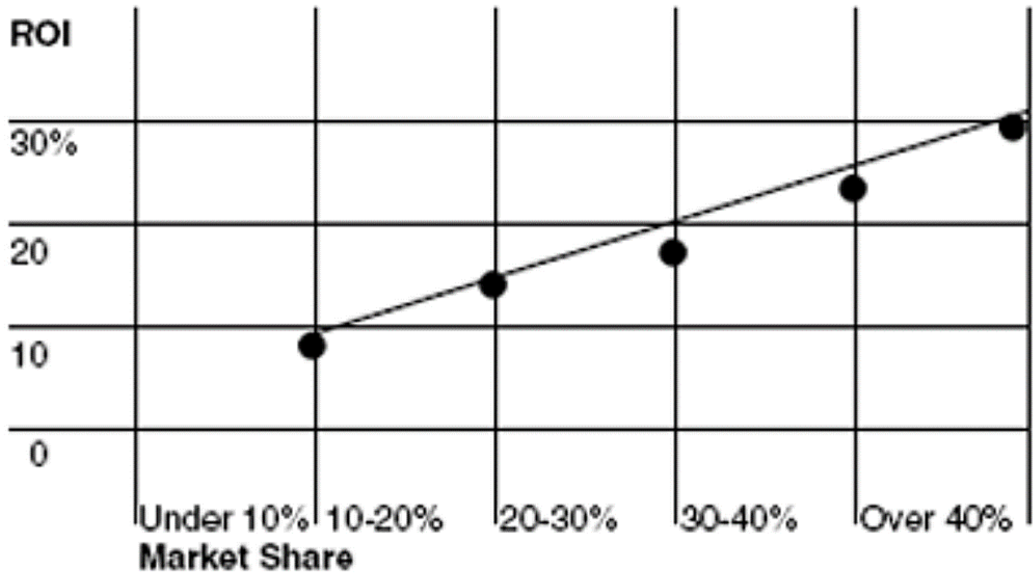
Advantaged Market Share

The Lead | March 2024

Relationship Between Market Share and Pretax Return on Investment (ROI)



Source: Harvard Business Review.

We are entering the season of March Madness, when college basketball teams compete in a tournament to determine which is the best. After weeks of competition, the teams get whittled down through intense competition. We note that year in and year out, certain teams consistently compete in those final weeks. These programs appear to hold a sustainable advantage in terms of recruiting top talent and coaches, driven by a combination of factors.

We believe the same dynamic can be witnessed in the stock market. The global economy is a competitive environment, with the U.S. market arguably being the most competitive. What makes an advantaged company? For savvy investors, there are some companies that not only survive, but thrive and dominate their markets. We believe the company's programs create advantages for their businesses to consistently win in the marketplace. For clients, this means these companies seek to invest to enhance their advantages and strive to reward us with dividend growth and further returns of capital.

In our view, one notable characteristic of an advantaged company is growing its market share by winning more in their chosen market than their competitors. In relation to March Madness, they are putting more points up on the scoreboard.

In the early 1970s, Harvard Business Review began reporting on a project sponsored by the Marketing Science Institute and Harvard Business School. The purpose of the article was to show the relationship between market share and ROI, as the graphic above shows. Simply put, we believe companies with greater market share are more profitable.

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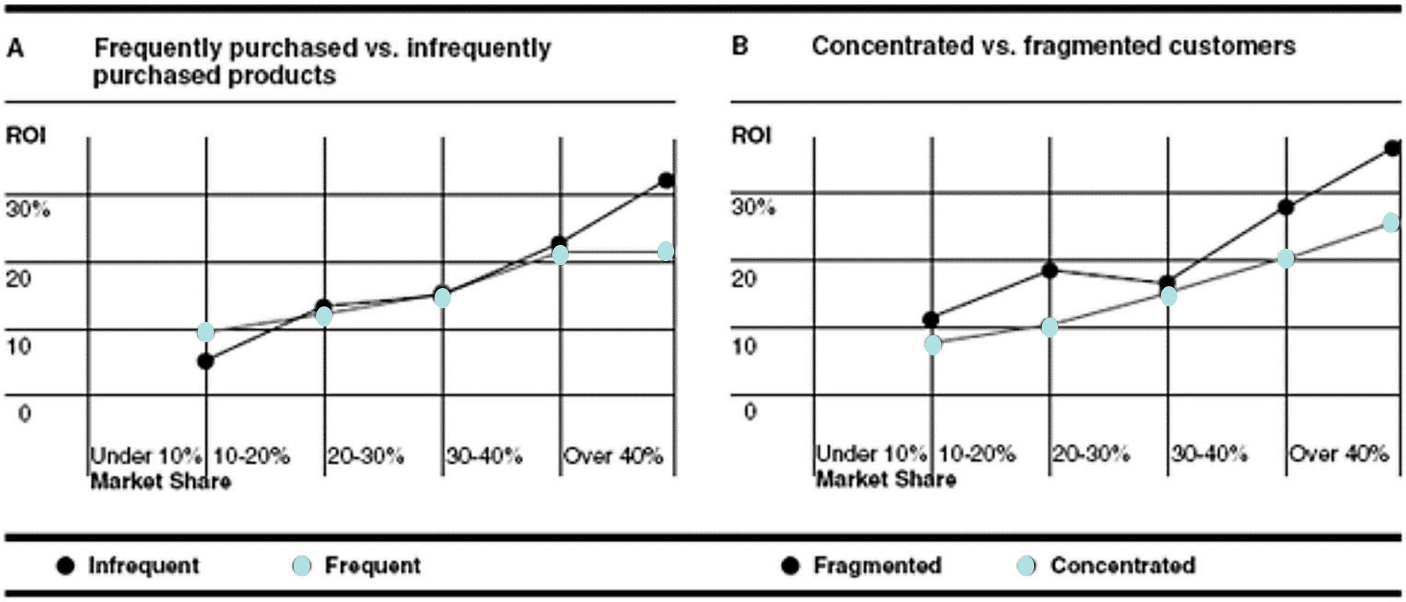
Industry Variations in the Market Share/ROI Relationship



Source: Harvard Business Review.

Why does greater market share drive greater profitability? As a company's market share increases, it may earn higher profit margins, including through a lower purchase-to-sales ratio through vertical integration. In addition, it tends to have lower marketing costs, due to a percentage of sales employing an internal sales force for industrial companies. For consumer companies, they benefit from mass media advertising and expanded presence across retailers' shelves. Finally, we believe greater market share enables companies to create higher quality products and charge higher prices. Once these advantages are achieved, they may provide barriers to entry, making advantaged leadership positions more sustainable.

Just as each college basketball team fields its team seeking to win, we seek to field a portfolio of advantaged companies with strong and potentially growing market shares to position our clients to win.

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.

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.

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.

The S&P 500 Dividend Aristocrats is a stock market index composed of the companies in the S&P 500 index that have increased their dividends in each of the past 25 consecutive years.

Dividend Policies: Dividend Paying vs. Non-Paying: Each stock's dividend policy is determined by its indicated annual dividend. We classify a stock as a dividend-paying stock if the company indicates that it is going to be paying a dividend within the year. A stock is classified as a non-payer if the stock's indicated annual dividend is zero. Prior to July 2000, the indicated annual dividends were updated on a quarterly basis. Since July 2000, the indicated annual dividends are updated on a daily basis, so the most up-to-date information is used. The index returns are calculated using monthly equal-weighted averages of the total returns of all dividend-paying (or non-paying) stocks. A stock's return is only included during the period it is a component of the underlying index. The dividend figure used to categorize the stock is the company's indicated annual dividend, which may be different from the actual dividends paid in a particular month.

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: **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. **Return on Investment (ROI)** is a popular profitability metric used to evaluate how well an investment has performed. ROI is expressed as a percentage and is calculated by dividing an investment's net profit (or loss) by its initial cost or outlay. (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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