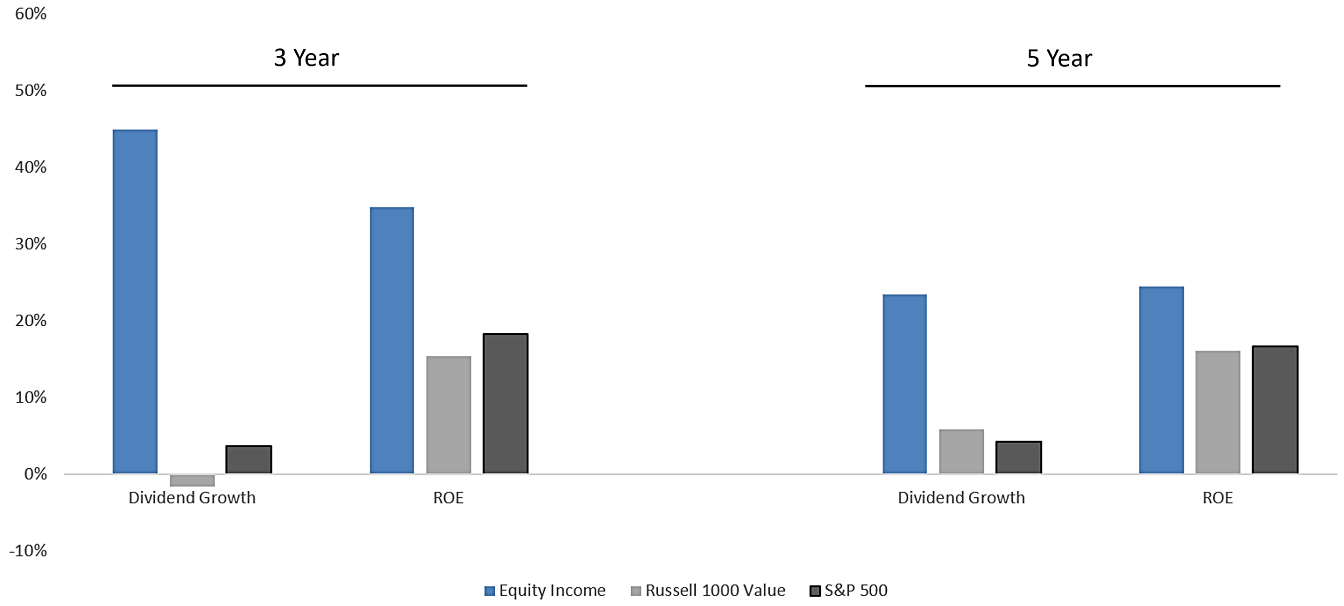
Perspective on Quality and Dividend Growth

The Lead | May 2023

Sterling Capital Equity Income Leading Contributors' Characteristics



"Leading contributors" are the top five contributors to performance over the time periods referenced. Sources: Sterling Capital, Bloomberg L.P.

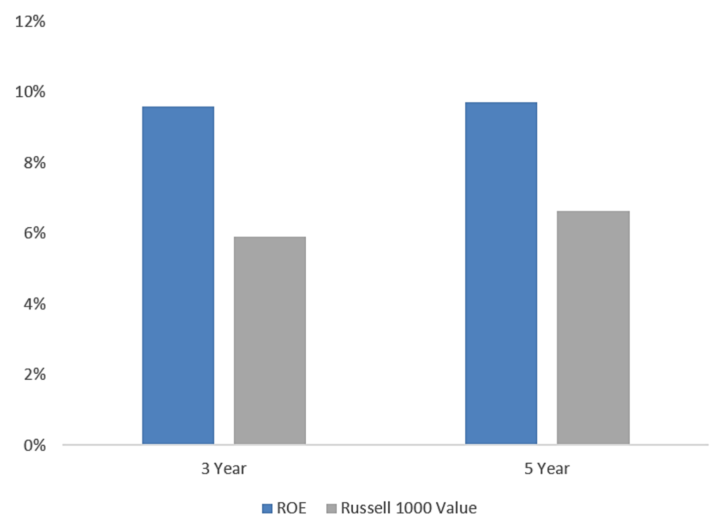
Following on the heels of last month's Lead, we thought it would be helpful to assess what has worked over the trailing three- and five-year periods in the equity market as it relates to our strategies. One nice aspect of running real money strategies is the ability to go back and assess what was helpful in delivering for our clients and what was not.

In our study, we took a closer look at the characteristics that we believe were additive to performance for the trailing time periods ended December 31, 2022. In this assessment, we took the characteristics for leading contributors for our Sterling Capital Equity Income strategy and looked to see if there were any similarities compared to the Russell 1000® Value and S&P 500® indices. The results are in the chart at the top of the page and reveal that overall, these contributors had materially stronger dividend growth than the major indices. These stocks also had stronger returns on equity (ROE) than the average for the aforementioned major indices. We can see that this observation is consistent across the different time frames.

We would note that the strong performance of higher ROE stocks was also witnessed in the Russell 1000 Value, for example, as seen in the chart on the right.

BofA Global Research provided data for the performance of ROE over these timeframes, and it performed well relative to the Russell 1000 Value. In comparison, valuation metrics such as Enterprise Value/earnings before interest, taxes, depreciation, and amortization (EBITDA) were not additive, according to BofA Global. This was consistent with our Equity Income strategy.

BofA Global Research Return on Equity



BofA Global calculated and rebalanced monthly.
Sources: BofA Global; Bloomberg L.P.

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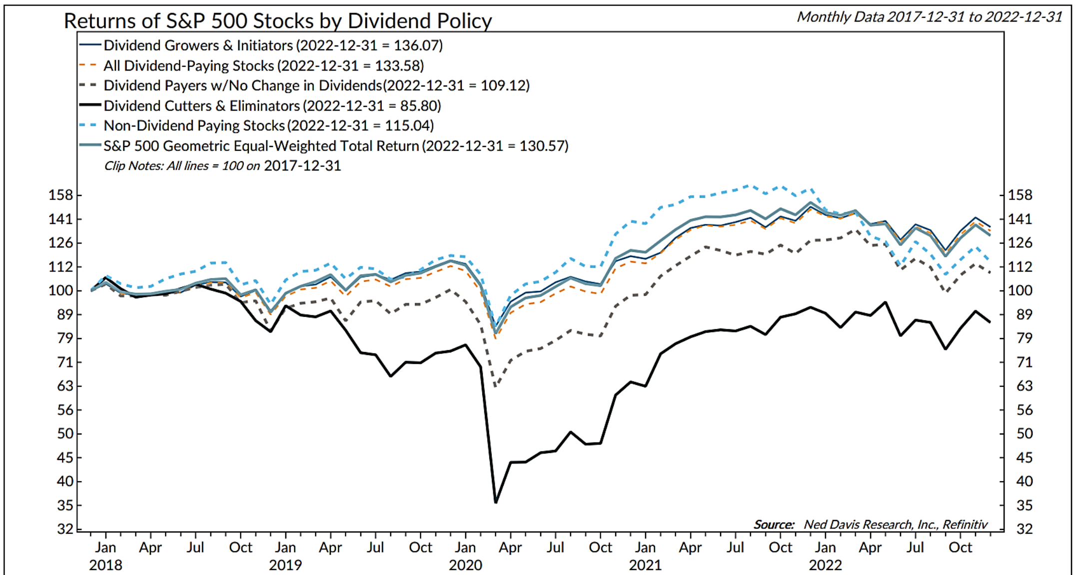
Returns of S&P 500 Stocks by Dividend Policy



Returns Based on monthly equal-weighted geometric average of total returns of S&P 500 component stocks, with components reconstituted monthly.

Portfolio Performance Statistics
Analysis Dates: 2017-12-31 - 2022-12-31

Portfolio	Gain/Annum %	Growth of $100
Dividend Growers & Initiators	6.4	136.1
All Dividend-Paying Stocks	6.0	133.6
Dividend Payers w/No Change in Dividends	1.8	109.1
Dividend Cutters & Eliminators	-3.0	85.8
Non-Dividend Paying Stocks	2.8	115.0
S&P 500 Geometric Equal-Weighted Total Return	5.5	130.6

Customized client version of S09

NDR

Data is as of 12.31.2022. Source: Ned Davis Research.

We believe dividend growth was additive to our Equity Income strategy over the time periods studied on the prior page, which is consistent with the data from Ned Davis Research displayed above.

As an investment team, we seek to accentuate the benefits of our investment process to deliver positive outcomes for our clients. By looking back in time, we learned that key components of our investment pillars combined with dividend growth often have the capacity to deliver in line with these objectives.

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. Chip earned the Certificate in ESG Investing, which is developed, administered and awarded by the CFA Society of the United Kingdom. He holds the Chartered Financial Analyst® designation.

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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.

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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.

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: **Return on Equity (ROE)** is a measure of a company's annual return (net income) divided by the value of its total shareholders' equity (i.e. 12%). Alternatively, ROE can also be derived by dividing the firm's dividend growth rate by its earnings retention rate (or, 1 – dividend payout ratio). **EV/EBITDA** is a ratio that compares a company's Enterprise Value (EV) to its Earnings Before Interest, Taxes, Depreciation & Amortization (EBITDA). The EV/EBITDA ratio is commonly used as a valuation metric to compare the relative value of different businesses. **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. (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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