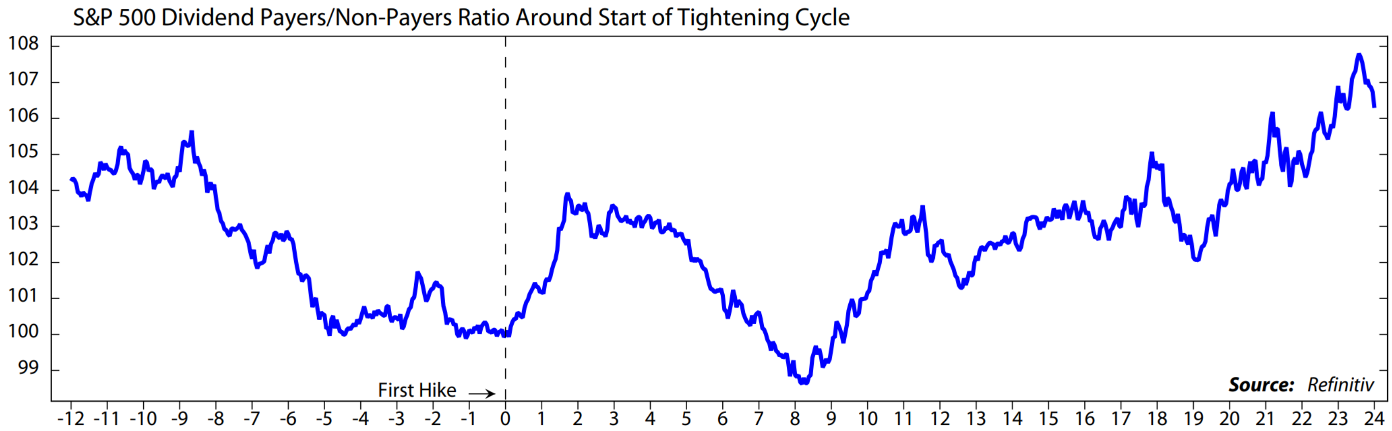
Balance Sheet Season

The Lead | November 2023

Dividend Payers Tend to Outperform in Second Year of Tightening Cycles



Sources: Ned Davis Research; Refinitiv.

Our investment team is in the midst of earnings season. Every quarter, the companies we invest in provide us with a report card of sorts based on their financial performance and outlook for their business. We spend considerable time sifting through these reports to assess the underlying strength and trends for the businesses we own.

While it is called earnings season, we have experienced 11 rate hikes over the past 16 months, and the focus for investors is gradually turning to balance sheet season. Higher interest expenses are beginning to impact companies in the S&P 500® Index as seen in the chart on the next page. Rising interest costs are causing companies that fund their businesses through borrowing to reassess their priorities. Do they continue to invest in a new plant or product that no longer meets their return requirements? By funding fewer projects, does this begin to slow their revenue growth rate?

We prefer to invest in companies that can limit their exposure to these tough choices. By investing in quality companies that we feel generate higher-than-average returns on capital, we believe they have more control over their business and do not depend on excessive debt to fund it. Within our Sterling Capital Equity Income strategy, we own dividend-paying stocks. Dividend payers offer evidence of financial strength and financial health by demonstrating the ability to reward their shareholders with cash proceeds from their business each quarter. Historically, this is why dividend payers tend to outperform later in an interest rate tightening cycle, as seen in the chart above.

Payers Performance After First Hike

Event Date	12 Months	24 Months
1/15/1973	14.7	9.2
8/31/1977	-7.5	-5.3
9/26/1980	7.8	9.4
9/4/1987	5.9	3.5
2/4/1994	2.9	4.3
6/30/1999	-22.6	3.7
6/30/2004	7.3	11.7
12/16/2015	12	13.9
3/16/2022	2.7	N/A
Median	5.9	6.7
% Positive	77.8	87.5

Source: Ned Davis Research.

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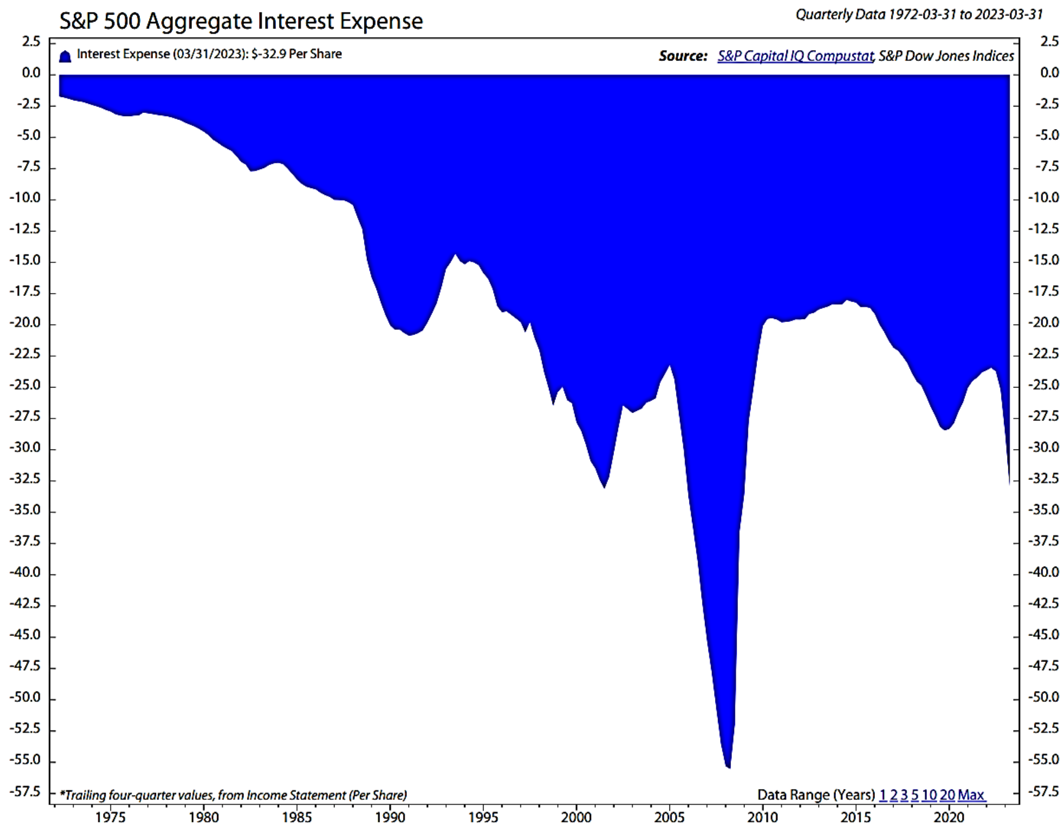
SPX Interest Expense Highest Since Great Financial Crisis (Quarterly Data 03.31.1972 – 03.31.2023)



*Trailing four-quarter values from Income Statement (per share). Source: Ned Davis Research.

Looking back at various tightening cycles shows how dividend-paying stocks' median performance improves further into the tightening cycle, as does the likelihood of success as seen in the chart above. One final note is that Ned Davis Research data shows that high dividend growth stocks outshine high yielders in a similar fashion in terms of performance and likelihood of success. This perspective reinforces our conviction that owning quality companies with strong balance sheets and demonstrated dividend growth will likely position our clients well as we enter the later stages of the current interest rate tightening cycle.

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.

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.

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. (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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