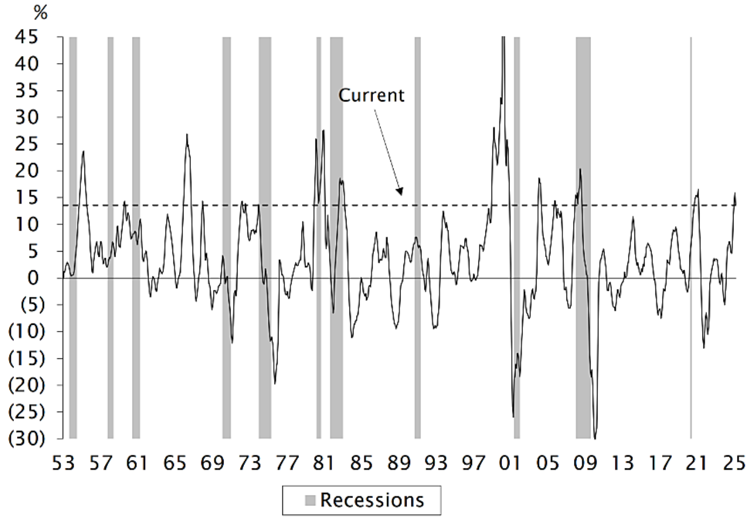
Raising the Bar

The Lead | March 2025

The Top Quintile of Nine-Month Stock Price Trends[1]
Trailing 12-Month Returns (1953 - February 2025)



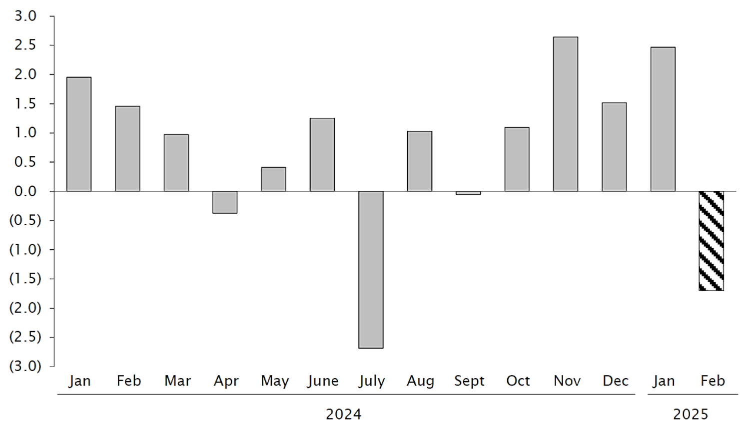
Source: Empirical Research. [1]Equally-weighted data smoothed on a trailing three-month basis.

This month, we're happy to share some market dynamics that we observed anecdotally but now have facts and figures to support. For the past two years, investors have experienced a powerful momentum-driven market. In investing, momentum is like a train – once it gets started, it is propelled in the same direction. Momentum investing capitalizes on our herding behavior when investors choose upward-trending stock prices and believe they will continue. Many times they will combine signals, such as when analysts who publish earnings estimates on these companies' stocks revise their earnings forecasts upward to help verify the upward direction of a stock.

In terms of price momentum, we can see from the Empirical Research chart at the top of the page that over the last 12 months, price momentum has had one of the best performance periods in seventy years. Earnings revisions tend to have short performance signals, but we believe there is a common thread between price momentum and earnings momentum, as seen in the chart to the right. It shows that stocks that have seen their earnings estimates revised upward have consistently outperformed over the following month.

Typically, this type of tight relationship is seen coming out of a recession. We believe the 50 basis point (bp) fed funds rate cut last year (the first this century outside of a major crisis such as the housing crisis, Global Financial Crisis, or COVID-19) contributed to this differentiated dynamic in late 2024.

Relative Returns to the Top Quintile of Earnings Revisions for Large Capitalization Stocks[1]
2024 - February 2025



[1]Equally-weighted stocks measured over one-month holding periods.
Y-axis is percentage. Source: Empirical Research.

This past month has been challenging for momentum stocks and earnings revisions as the bar for earnings revisions has been raised.

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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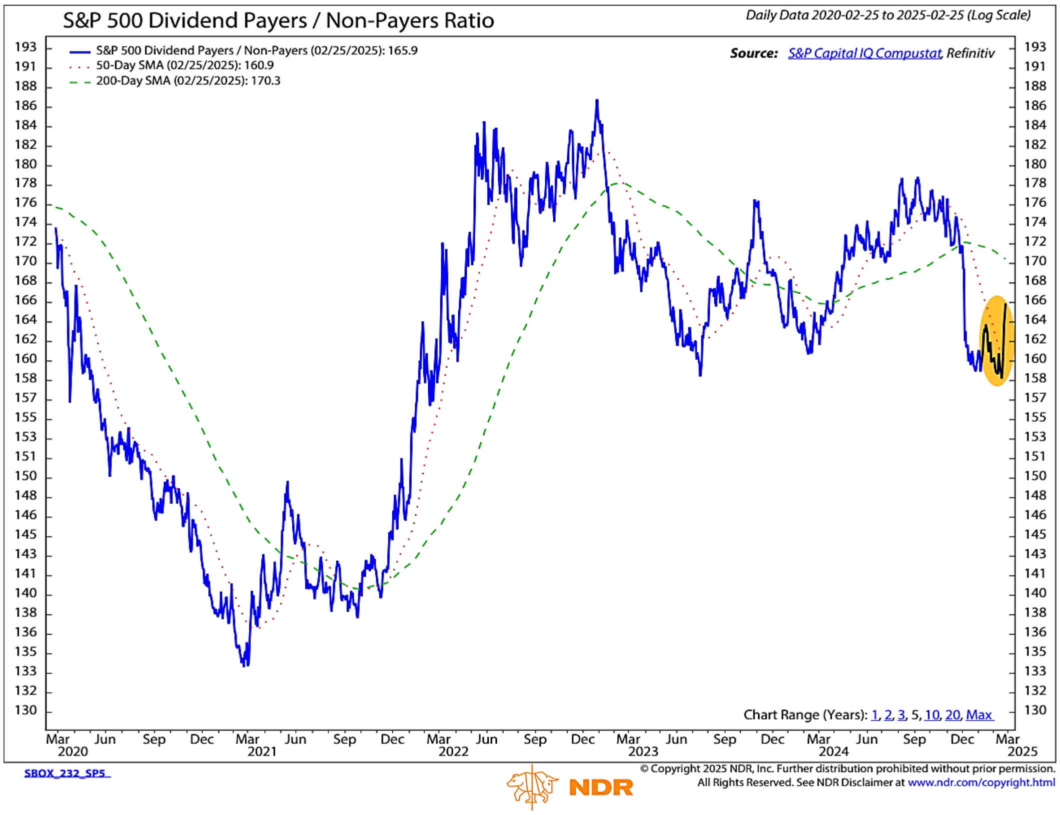
Dividend Payers Jumped to 2.5 Month High versus Non-Payers



SMA: simple moving average. Source: Ned Davis Research.

Conversely, dividend payers have perked up after underperforming materially since the 50 bp rate cut. What gives? We believe that with the Federal Reserve (Fed) signaling mid-month that interest rates may remain closer to their 2023 high than they expected due to persistent inflation concerns, the prospects for a more challenging macroeconomic environment increased the appeal for dividend-paying stocks. Our observation is that the aggressive monetary policy in late 2024 accentuated momentum linked to earnings revisions, especially in economically sensitive stocks with non-payers outperforming dividend payers, as seen in the chart above. With the Fed signaling less stimulus in 2025, we may see more of a balance in stock performance between dividend payers and non-payers.

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.

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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: **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 federal funds rate** is a cornerstone of U.S. monetary policy and a key driver of economic activity. It refers to the target interest rate range set by the Federal Open Market Committee (FOMC), the policymaking body of the Federal Reserve System. (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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