



*During the recently ended quarter, net of fees, the ValuePlus composite under-performed the Morningstar Large Cap Value by 220 basis points and under-performed the S&P 500 Value by 80 basis points. The 1-year return on the composite was 7.5% (gross of fee) 7.2% (net of fee); the 5-year return on the composite was 11.1% (gross of fee) 10.7% (net of fee); and the 10-year return on the composite was 11.0% (gross of fee) 10.7X% (net of fee).*

ValuePlus continued its upward trajectory in the third quarter, albeit nominally, and in a not too dissimilar fashion as in the preceding quarter. Common benchmarks extended their relentless concentration in the largest market capitalizations, taking away returns from most other equities. To wit, the S&P 500 *market-cap weighted* index increased by over 2% for the quarter while the same benchmark—*equally weighted*—declined by nearly 2% (*source: FactSet - SPXEW*). Piper Sandler recently noted that “This comes after US equities finished higher on Friday, with the NASDAQ hitting a new all-time high. However, equal-weight S&P 500 suffered its seventh straight weekly decline.” Barrons most recent cover titled “A Market Divided” described the bifurcation reminiscent of a certain prior bubble nearly three decades ago. The list goes on.

Through that lens, ValuePlus outperformed the equally weighted S&P 500 and underperformed its market-cap weighted sibling which has nearly 40% of its holdings in the nine largest technology and AI-related companies (*net-of-fees*). As with the S&P 500, similar peculiarities exist with Value benchmarks. For example, the Russell 1000 Value benchmark has only three companies with weights exceeding 2.5%; nothing out of the ordinary so far. Each of those companies’ actual weights, however, exceed 5% and they are Amazon, Apple, and Microsoft. The three largest positions in this widely recognized Large Value benchmark by a factor of at least two compared to any other index constituent happen to all be technology related.

In looking at the S&P 500 equal weighted index, we find no qualms with its sector allocation. In general, its sector weights fairly represent the overall economy. Industrials are the largest weight at approximately 17% of the overall benchmark followed by technology at 16%, financials at 15%, and healthcare at 12%. Meanwhile, the market-cap weighted S&P 500 is altogether different due to its nearly 40% weight in technology. Even this is misleading since companies like Amazon, Alphabet, and Meta fall under consumer discretionary and communications sectors. This level of concentration crowds out all other representative parts of the economy. Some of our peers have called this market broken, and it may be. We believe we are witnessing the setup for poor prospective returns on the part of investors who blithely believe they own a wide swath of the economy. They do not!

As we have mentioned in reports past, the crowding-out effect of this historic concentration offers a desirable outcome for those willing to dig a little deeper. As value investors, our opportunity set continues to expand, and we are presented sound companies at valuation levels not seen in years. The current market is creating distortions that play to our advantage long-term.

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During the quarter we initiated positions across four sectors: insurance, healthcare, materials, and consumer discretionary. W. R. Berkley, a company we have owned in other portfolios for a few years, has declined recently due to a softening insurance pricing market and renewed fears that higher interest rates will hurt the company's investment book. While the first concern is valid, the second is not. It is in fact this same concern which first brought Berkley to our attention in 2023 during the interest rate shock environment. That was the year companies like First Republic, Silicon Valley Bank, Charles Schwab, and others experienced runs on their assets. The former two were acquired while Schwab slowly recovered from its self-inflicted wounds. We bought Schwab subsequent to its 2023 debacle. Unfounded concerns regarding Berkley's investment book are now providing us with an attractive entry price. We do not deny the soft underwriting environment, yet this headwind is counterbalanced by an owner-operator mindset which has proven itself as underwriting discipline. When management is unable to underwrite with a fair assumed return, it instead regularly deploys its capital towards shareholder returns. It has been an astute purchaser of its shares at depressed prices and rewards shareholders with regular and special dividends. As recent owners in *ValuePlus*, we look forward to being rewarded, along with management, in this well-run operator.

Rising interest rates have had a harmful effect on consumers' behavior and ability to purchase homes and autos as housing starts and new car sales have stagnated for years. The Fed's recent moves have not assuaged the market, the bond market being exhibit A. Consequently, many consumer discretionary and interest sensitive industries have seen their stock prices decline along with their strained businesses. Companies that until recently were able to grow through debt issuance are all the more challenged. Yet such industries are cyclical by nature. *ValuePlus* currently has little exposure to the overall housing and automotive markets and the majority of our industrial exposure is not pro-cyclical. From that standpoint, we are well insulated. Nevertheless, stock declines appear, in cases, excessive relative to what may be a softening of end markets. Opportunities are presenting themselves in those industries and where there are at least a few that have leading market positions, sustainable end-markets—albeit cyclical—and sound financials.

Apparently, we are not the only ones. We do not seek confirmation from others to inform us of our investment decisions yet we find it interesting that Berkshire Hathaway has recently deployed significant capital in the housing market by purchasing a homebuilder outright and an interest in another through its common stock. We do not own any homebuilders but we are fairly certain that, as it has in the past, the market will recover at some point. With its long-term outlook, Berkshire Hathaway is comfortable waiting for the turn. Similarly, we initiated modest positions in two companies that are tied in some form or another to the direction in interest rates. Time is on our side as these companies are ignored by investors and reduced by mechanically-derived benchmarks.

Avery Dennison is the largest label stock company globally, providing labels of various kinds around the world to industries across the economy. While this industry may appear mundane, technology plays an essential part as labels become "smart," meaning that the evolution from simple to bar code to QR and beyond continues unabated. Customers from global apparel manufacturers to regional fresh protein processors need labels to provide greater amounts of information, from sourcing details to freshness, inventory management and pricing. Labels are an often ignored yet critical component of the supply chain where economies of scale are significant. Because of its market power, Avery Dennison can pass on input cost increases, albeit with a lag. The rising price of oil has had a temporary negative effect on production and transportation costs which has rendered shares attractively valued. Business fundamentals have always been desirable but our price sensitivity and need for financial soundness sometimes keep us on the sidelines. Shares are currently priced at the same level as five years ago while the underlying business continues to grow, from sales to earnings and dividends. We are in effect paying less for a larger company today than we would have as far back as 2021. Towards the end of the quarter we initiated a modest position in Avery Dennison, a position which may grow should shares languish for reasons that are technical and transient instead of fundamental in nature.

We also initiated a modest position in Pool Corporation, the nation's largest wholesale distributor of swimming pool and related backyard products and one of the only national wholesale distributors focused on the industry. Despite its

strong returns on capital and leading market share, its shares have declined over the past number of years as housing starts and related pool builds have declined. Combined with the after-effects of the surge in backyard activities during the Covid era, recently weaker fundamentals have impacted its valuation. It is noteworthy that nearly 65% of the company's revenues are related to maintenance, which tend to be recurring in nature, and an additional 20% of revenues are related to remodeling, renovations and upgrades which suggest that a mere 15% of sales are dependent on new pool construction. With a strong recurring revenue base and leading market position, we believe that consensus is putting a higher likelihood on a continuation of deteriorating fundamentals than what is actually warranted, thus providing us with an opportunity to own an industry-leading company at a modest valuation. We do not think that an improvement in residential construction is required to support an increase in the shares of Pool Corp. As with Avery Dennison, should shares continue to languish while fundamentals stabilize, if not improve, we would continue to add modestly to our existing position.

The strategy's exposure to healthcare is primarily driven by two dynamics. The first is that healthcare will, for the foreseeable future, be a driving component of the economy as it currently represents nearly a fifth of domestic economic activity. Second, we continue to find some of the most attractive values within this critically important sector and as such, our allocation to various companies within it continues to shift. In the quarter, we initiated a position in AstraZeneca, lowered Pfizer and Dentsply Sirona and let Becton Dickinson, a fairly recent addition, increase in its contribution. Continued volatility in the sector has enabled us to re-allocate among companies with what we deem to be better long-term risk-reward tradeoffs.

From a performance attribution standpoint, technology was, not surprisingly, the largest source of relative under-performance in the period. Mega-caps (Nvidia, Meta, Microsoft, et al) do not reward their shareholders with meaningful dividends, an important part of the ValuePlus mandate. In addition, from a fundamental standpoint, they are shifting from being high return on capital businesses to being much more capital intensive with less predictability of future cash flows. They are currently in favor yet as we've witnessed in the past, markets are not static and what is in favor one day can very much be out-of-favor the next. That passive inflows continue to move to those businesses should worry many. Partly mitigating technology's negative impact to relative returns, ValuePlus' energy, financials, healthcare and industrial exposure all contributed to returns.

As we compare ValuePlus' sector allocation to increasingly concentrated benchmarks, the strategy appears to be much more diversified in our exposures. We have never made a "bet" on a single industry. We have instead purchased companies that are leaders among their peers, in industries that span the economic gamut all the while paying attention to valuations and seeking predictability of shareholder returns. While not often discussed in mainstream media, many companies currently fit this bill and they are the ones in which we are investing.

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*Past performance is not indicative of future results. Performance for periods greater than one year is annualized. Returns are calculated using a time-weighted return and include the reinvestment of all income. Gross of fee performance is reduced by any transaction costs. Net of fee performance is further reduced by actual management fees. The securities identified are not a recommendation to buy or sell and do not represent all of the securities purchased, sold or recommended for client accounts. The reader should not assume that an investment in the securities identified was or will be profitable. The number of contributors versus detractors are loosely dependent on how the strategy performed versus its benchmark. Depending on how well the strategy did versus its benchmarks, the number of meaningful contributors or detractors will change from quarter to quarter. In general, if the strategy outperformed/underperformed its benchmark significantly, there will likely be a larger/smaller number of contributors than detractors. When only a small number of stocks are responsible for the majority of relative performance versus the benchmark the opposite may be the case. Any discussion of underlying stock specific returns is not to be relied upon as performance to achieve and only discussed as a means to communicate the strategy's performance relative to the market and does not reflect the deduction of fees. The analysis and opinion expressed in this report are subject to change without notice. Any investment characteristics of individual stocks presented are shown on a gross basis and do not reflect the deduction of management fees or other costs that investors have paid or would have paid. The deduction of fees and expenses reduces investment returns and would also affect the investment characteristics presented. The investments shown are provided as representative examples of SKBA's investment process and portfolio holdings. The criteria used to select the presented investments are the top and bottom contributors and the most recently added or removed holdings. Other investments held during the same period may have performed differently, including experiencing losses. Investment characteristics such as valuation metrics, dividend yields, market share, or other attributes are provided for informational purposes only and are not predictive of future performance or investment outcomes.*