
# 2Q 2026
# Value*Plus* Portfolio Review

*During the recently ended quarter, net of fees, the ValuePlus composite under-performed the Morningstar Large Cap Value by 287 basis points and under-performed the S&P 500 Value by 587 basis points. The 1-year net of fee return on the composite was 10.5%; the 5-year net of fee return on the composite was 10.5%; and the 10-year net of fee return on the composite was 11.1%.*

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For the quarter, Value*Plus* increased in value by approximately 3% on an absolute basis, bringing its year-to-date return to over 6% (*all net-of-fees*). During the first quarter's swift market declines, Value*Plus* not only exhibited downside protection but grew wealth for our clients and shareholders. It is not therefore altogether surprising to us that in the more recent market exuberance towards everything AI, the strategy should lag on a relative basis. This is indeed what occurred.

Companies within the Value*Plus* portfolio are not often disintermediated; rather, they tend to have durable business models. As value investors, we sometimes seek companies that are temporarily out of favor due to idiosyncratic events but rarely do they permanently lose their competitive relevance, even less so, suddenly. What more often tends to happen is that their stock prices are more volatile than their fundamentals. For example, AT&T shares increased by over 15% in the first quarter and declined by approximately 25% in the second quarter. This recent decline took place not from an elevated valuation level but from a modest one. Why might its shares have declined this much? The answer is that it is due to non-fundamental factors. In AT&T's case, some of the non-fundamental factors are perceptions that Starlink could launch a mobile service. However, as we see it, we are a few years away and billions of dollars in spending from it becoming a reality, let alone a competitive offering. These non-fundamental factors provide us with a significant opportunity set as volatility far exceeds changes in fundamentals yet are responsible for wide divergences in price over value.

Another interesting non-fundamental factor affecting our investing landscape are changes to the Russell 1000 Value Index, which have called into question whether or not the index still represents a value portfolio. Last year the Russell 1000 Value benchmark doubled its exposure to the communications sector by crowning Alphabet (Google) the largest company, not simply in the sector, but in the index as a whole! Meta was the second largest position within communications. AT&T and Verizon became fractions of a percent each as a result of this reconstitution. As the benchmark has once again reconstituted, we relay this quote from Russell Investments, the index providers website: "broadly, value managers have added to Amazon while reducing exposure to Alphabet following the latter's strong rally over the past year. Opinions on Apple and Microsoft are more mixed, but most managers expect to maintain positions, even at active underweights, given their combined benchmark weight of roughly 10% following the reconstitution." As an important and widely tracked domestic value benchmark, the Russell 1000 Value now claims Amazon, Apple, and Microsoft as its three largest holdings, at over 15% of the total. It can perhaps be inferred that the index suffers from a significant identity crisis. Our greater concern rests on the fact that there is no longer much differentiation among the broad market, growth indexes, value indexes, and international indexes. They are all heavily exposed to very few stocks. If one pursues a passive investment plan, one ought to be comfortable with such concentrated exposure.





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We live in an era in which certain technology advancements are touted as seismic and there seems to be no shortage of promoters. We do not repudiate such advancements, simply the notion that they will obviate the need for everything else. From our vantage point, the market's valuation is as bifurcated today as it has been in years. AI may be groundbreaking, but the existence of technological revolutions is not. How many railroads, auto companies, airlines, communications providers or web portals exist today compared to the early days of those inventions? Not many. Electric vehicles offer a useful example. At the turn of the century, the 20th century, not the 21st, there were apparently over 200 electric car companies in the U.S. with over a third of all cars sold powered electrically. Clearly the market did not end up favoring electric cars back then though few would have suggested as much at the time. The parallel being that we are still in the very early innings of AI adoption and that it is premature to conclude who the winners and losers will be. Technologies may be revolutionary but adoption tends to be evolutionary. Technological progress is rarely linear.

From a portfolio attribution standpoint, our technology exposure offers a few striking statistics. IBM increased by approximately 17% during the second quarter, NXP Semiconductors by over 40% and each of Texas Instruments, Cisco and NetApp by over 50%. Our overall technology holdings increased by over 40% in the quarter! These returns are more than satisfactory for an entire year, let alone one quarter, yet Technology was nevertheless Value*Plus'* single largest detractor to relative returns during the period. How is that possible? How can companies that increased in price so much detract from relative returns? "Relative" was indeed the operative word and the reason those companies detracted from Value*Plus'* overall returns is that the Index had nearly twice our sector exposure and its returns exceeded 80%! Such extraordinary outcomes underscore just how distorted we believe the current market environment has become, where exceptional absolute returns can still translate into meaningful relative underperformance.

As fewer and fewer companies lead most benchmarks relentlessly higher, many fundamentally sound businesses are left behind due to the crowding out effect. A few of our holdings declined in the period, some for fundamental reasons and others not. AT&T and Verizon, both top contributors in the first quarter, detracted from returns this quarter. Adding insult to injury, Verizon was eliminated from the Dow Jones index on June 29 to be replaced by Alphabet (Google). AT&T and Verizon's businesses are not in fact deteriorating yet indexation along with the threat of Elon Musk's Starlink entering the market was enough to trigger the sell-off. The strategy's defense companies also declined during the period despite their fundamentals being as strong as they have been in decades. We have owned and discussed RTX and LHX for a few years as they have been a significant part of our overall industrial exposure. Markets are discounting mechanisms, however, and we understand the negative short-term price reaction to prospective detente in the Middle East. We also reduced our exposure to these companies earlier this year as their valuations exceeded their fundamentals. Due to recent stock price declines, the two companies are now more reasonably valued and based on their strong prospects, we are maintaining some level of exposure.

Medtronic and Dentsply Sirona declined in a generally weak healthcare sector—a perfect example of the above-mentioned crowding-out effect. Dentsply additionally suffers from company specific issues which it is in the process of resolving, albeit more slowly than in our original hypothesis. Our modest exposure remains our risk control against the company being unable to improve its competitive position over the foreseeable future. The company's dividend near-elimination will enhance its financial position, yet Value*Plus* seeks companies that are able to grow, not eliminate their dividends. We at times make exceptions for cuts as they are part of a greater capital re-allocation strategy but eliminations are another matter. We are likely to exit in the upcoming months.

Nike falls under our turnaround category as its competitive position has deteriorated due to prior management's short-sightedness. The company's prioritization of short-term profits over brand relevance during Covid resulted in stale assortments and collections and excessive exposure to the direct-to-consumer channel, which is highly promotional. The company's issues have been well documented as it has lost market share to both domestic rivals and Chinese upstarts; neither should be under-estimated. The consumer landscape has clearly changed over the last few years but a re-invigorated focus on athleticism and product innovation should prove favorable.

The recent decline in the CME can be attributed to the convergence of a few financial innovations; perpetual futures ("perps"), prediction markets and decentralized exchanges, all of which fall under the headings of cryptocurrencies and blockchain technology. What does this have to do with the traditional exchanges, you ask? At stake is to what extent certain unregulated futures and options contracts will take away from established ones traded on centralized exchanges like the CME, the ICE and the CBOE. With companies like Hyperliquid, Kalshi, Polymarket, Coinbase, and Robinhood now offering perps on cryptocurrencies, plans are in place to do the same for other more widespread contracts such as indexes, pre-IPO stocks and commodities. Some are already available overseas. Should these be allowed on our shores, the threat to established options and futures exchanges is real. So real in fact that the CME recently sued the CFTC on grounds that such products fall under the definition of "swaps" not "futures," as the CFTC itself clearly stated a couple of years ago. Swaps need to follow a certain regulatory framework whereas the CFTC chair Michael Selig recently allowed these contracts to "self-certify." It is clear that the CFTC has shifted 180 degrees as far as regulation is concerned. As a result, the CME stock price declined not due to weak profits but due to the potential threat to its business from unregulated upstarts. We believe this is a legitimate threat as the administration is likely to be hands off for the time being. Nevertheless, centralized exchanges should ultimately be able to adapt to the lower regulatory regime as well as offer competing products. Should this come to bear, margins may still be lower than for certain legacy products but many factors are at play, and providing unregulated contracts does not guarantee durable profits. It is premature to conclude that the centralized exchanges will neither be able to protect their franchises nor to adapt to changing market structures, as they have done in the past.

Some of the largest contributors in the quarter included Kontoor Brands, Citigroup, US Bancorp, Healthcare Realty, Pinnacle West, and Phillips 66. Kontoor continues to impress us from a fundamental standpoint as we believe its recent business realignment—divesting Lee and acquiring Helly Hansen—will be highly accretive to its long-term goals. It will be receiving up to $1 billion for Lee, which, while profitable was not growing, in exchange for Helly Hansen which is growing rapidly and whose margins will improve with volumes. We are paying very little for a company with such desirable attributes of shareholder returns. By that we mean that the company will be buying back up to a fifth of its shares with proceeds, should be able to grow earnings by over 10% per year and offers an attractive dividend yield.

With respect to the normalized yield curve, our outlook for banks is more constructive than it had been for many years. The environment for banks has markedly improved due to the ability to generate profits from lending as well as from a deregulatory regime. Banks' capital requirements have at times been onerous, in our opinion, and these have recently diminished. We also believe that consensus inflation expectations are higher than what we are likely to experience. In this sense, we side with the newly appointed chair of the Federal Reserve. Should this prove to be correct, it should translate into the continuation of a relatively steep yield curve, providing benefits to banks and other interest-sensitive industries.

During the quarter we initiated a position in ADP and eliminated Corebridge as the former recently declined by approximately a third in price while the latter increased from earlier declines. With ADP, we paid depressed prices for a business with leading market share in an area that is not likely to be disrupted. AI has hit software and service providers very hard based on the threat to their businesses. While very real for some companies, it should not be viewed under the same lens for all. We recently concluded that employers of all sizes are very unlikely to bring their payroll and human capital management (HCM) in-house simply due to AI's capabilities. At recent prices, we acquired shares in this leader in market share, in margins, in return on capital and in shareholder returns. In addition, ADP is a true dividend aristocrat all the while it has shrunk its net shares outstanding. We hope shares remain depressed so that we may add to our position.

As the market continues to focus on fewer and fewer industries, our ability to purchase companies like ADP increases. By investing in businesses with durable fundamentals, attractive valuations, and sustainable income generation, we believe the portfolio remains well positioned to deliver compelling risk-adjusted returns over our investment horizon.

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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. The analysis and opinion expressed in this report are subject to change without notice. Any investment characteristics of individuals 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.*