3Q 2024
Value*Plus* Portfolio Review

Downside protection time period stated since strategy inception (October 1, 1989). Benchmark statements versus the Morningstar Large Cap Value and Russell 1000 Value. Past performance is not indicative of future results. 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. During the recently ended quarter, net of fees, the ValuePlus composite out-performed the Morningstar Large Cap Value by 83 basis points and out-performed the S&P 500 Value by 44 basis points. The 1-year net of fee return on the composite was 28.7%; the 5-year net of fee return on the composite was 12.6%; and the 10-year net of fee return on the composite was 10.2%.

So much for "Value" becoming irrelevant in an era of Uber-cap technology stocks.

For the quarter ending in September, domestic large capitalization value benchmarks increased by high single-digits while Value*Plus* approached 10%. A quarter does not a record make, however, and what we are pleased with is not the strategy's returns over the last three months but rather, the strategy's returns over the last three decades, and longer. Over those relevant timeframes, Value*Plus* has provided desirable risk-adjusted returns by maintaining a positive gap between downside market-capture and upside market-capture. There are many ways to skin the euphemistic cat, but for Value*Plus*, over complete cycles, we have given back less in market downturns while capturing nearly all of the upside (*net of fees*). A portfolio with historical downside protection, above benchmark dividend income, below market valuation and attractive fundamentals seems like a prudent way to not only preserve capital over the long-term but to also grow it.

As it relates to Value with a capital V, in practice, the only difference between Growth and Value is the price one is willing to pay for an asset or a company and the cash flows or earnings that those assets offer. It is fairly easy to find "cheap" stocks yet many stocks are cheap for a reason and often stay that way. Until such companies improve their business of doing business, they deserve to be stuck in "Value" purgatory. What SKBA needs to see to be attracted to a company is not simply valuation attraction but also, and importantly, fundamental attraction. Do we want to pay very little for an eroding franchise or do we want to pay a fair price for a growing one? The combination of both factors, as opposed to simply finding "cheap" stocks, is not nearly as easy a strategy to implement. Perhaps, that is the true definition of Active Value, a category of which we clearly are proponents.

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Our exposure to financials from a security selection standpoint meaningfully hurt performance during the period; most other sectors contributed. AIG, The Charles Schwab Corporation, Citigroup, Corebridge Financial, Truist Financial, U.S. Bancorp and Wells Fargo all generally experienced flat or negative returns in the quarter. High correlation of returns among banks can be expected in the short-term, and we initiated positions in two of them during the quarter. We owe them much more time as part of the portfolio before announcing any sort of verdict. More on those later. From a correlation standpoint, Corebridge and AIG may also be somewhat tied at the hip, albeit unjustifiably, since Corebridge was recently separated from AIG with the latter still owning a meaningful part of the former. Charles Schwab we put in a unique category, having been a recent turnaround opportunity following the recent failure of certain banks in the spring of 2023. We are all the more attracted to all our financial holdings subsequent to their declines with the exception of Schwab. Much has changed between the spring of 2023 and the fall of 2024 and we have not seen as much fundamental improvement from Schwab as we would have preferred. In broad strokes, Schwab has zigged when it should have zagged too many times over the last few years. Prior to our ownership, it increased its exposure to banking while creating a significant duration mismatch on its balance sheet. Now that the yield curve is improving for banks in general, it is reducing its direct exposure, and in our opinion, making it even less attractive to own. Schwab has an interesting combination of risks in that it has experienced growth due to its banking franchise and also has capital markets exposure. As we turn increasingly cautious with respect to equity markets in general, we are less attracted to this part of the company's business while the banking side is unlikely to benefit as it would have if the company had maintained flexibility with its lending exposure. Our return from having owned Schwab has been more than satisfactory; what we are disappointed with is the direction that management has taken during recent inflection points. The company's board of directors may have recently recognized this with the announced retirement of Walt Bettinger as CEO. Should his successor right the ship, we will re-evaluate our stance. In the meantime, we have reduced our exposure with the intention of eliminating our position over time.

To say that markets are topsy-turvy would be an understatement. For example, a pertinent one as it relates to banks, a reduction in fed funds rate by the Federal Reserve, as we just witnessed from Chairman Powell a couple weeks ago, is often negative for banks. Lowering rates is an indication of a slowing economy and weak lending; economic weakness is generally negative for bank profits. In 2024, however, banks have not been able to generate normal profits due to the inverted yield curve. In simple terms, over the last few years, banks have taken risks by lending at low rates for extended periods of time while they have had to pay higher rates in the short-term. This is but one definition of a duration mismatch, an environment that negatively impacted most banks and was the demise of a few over the last couple of years. If a bank locks up its capital with a loan for five years at 4% but has to pay more than that in deposits every quarter, it loses money. Most readers have undoubtedly heard or read of their neighbors or colleagues locking in their mortgage at rates below 3% in 2021. If a bank loses money on every loan it makes, at some point, it will stop lending or else go out of business; First Republic and SVB are textbook examples of those repercussions. This is the environment banks have been in due to the inverted yield curve. However, since today's economy is relatively strong and the Fed has now begun to lower rates at the short end, those deposits will begin to cost the bank less than 5%, making loans more profitable. Banks need a normal yield curve, meaning that short-term rates should be lower than long-term rates to achieve normal profits. For the first time in years, the curve is returning to a more normal state and may now steepen, providing greater flexibility to many banks.

That, in essence, is our attraction to U.S. Bancorp and Truist Financial, our two recent initiations. As with many holdings, we are quite familiar with both companies, having owned them in the past. U.S. Bancorp caught our attention prior to the global financial crisis as it was at the time one of the most neglected by investors. It was neglected for reasons we treasured, and that is that the bank was refusing to lend unless it could make profitable loans. At a time when Countrywide Financial and Washington Mutual were scrambling for market share, U.S. Bancorp was taking a step back. It was doing the opposite of what most others were being rewarded for, which was lending during the greatest financial bubble in decades at paltry profits. A couple years later and neither Washington Mutual nor Countrywide Financial—among many others—survived while U.S. Bancorp became one of the largest banks by purchasing assets and

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competitors following the crisis. We appreciate the bank's conservative mindset which gives us comfort should economic growth weaken. The company will do the right thing for its shareholders.

Outside of Financials, Merck, NXP and FedEx were also among the largest detractors to return in the period. Their recent lackluster performance does not overly worry us as they have all generated positive returns during our ownership period.

Most sector exposures contributed to excess returns with stock selection responsible for majority of the strategy's excess returns. Stocks with the greatest returns during the period included 3M, Kenvue, IBM, Royal Philips, and Brookfield Asset Management. Their contributions might differ somewhat depending on the timing of purchases and their size in the overall portfolio. The largest contributors were IBM, Royal Philips, Kinder Morgan, Kontoor Brands and RTX Corp.

During the quarter, as mentioned, we initiated positions in U.S. Bancorp and Truist Financial, and also purchased American Electric Power. For many years, utilities in general offered neither valuation nor fundamental attraction. The increase in rates over the last few years gradually resolved the valuation problem while recent appreciation towards electricity demand growth is resolving the fundamental problem. Utilities will have to spend significantly in order to provide increases in consumption growth but the profits they will be allowed to earn by regulators is likely to improve over the next few years. Kenvue, Medtronic, 3M and AirProducts were added to in times of stock price weakness.

We eliminated Verizon, Equinor and Rio Tinto from the portfolio and reduced exposure to Wells Fargo, Merck and NetApp.

As we look forward to the next quarter, year and decade, our outlook can be described as being cautious. Those who know us may wonder how this differs from our usual stance. And that is perhaps a good place to end this report. We are not market timers—rarely does anything good come out of trying to act on market predictions—but we do always look at all of our holdings with an eye to what could go wrong. We attempt to take care of the downside as the upside generally takes care of itself, assuming, once again, that our holdings exhibit fundamental attraction. That is, in essence our dual mandate.

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