



During the recently ended quarter, net of fees, the SociallyResponsible Value composite under-performed the Morningstar Large Cap Value by 353 basis points and under-performed the S&P 500 Value by 259 basis points. The 1-year net of fee return on the composite was 9.1%; the 5-year net of fee return on the composite was 12.3%; and the 10-year net of fee return on the composite was 10.4%.

What more is there to say about the state of the markets? The strength of this rally has been nothing short of remarkable, yet we've discussed it so many times, we're not sure it bears repeating. The S&P 500 continues to make new highs, and the familiar concerns around narrow leadership, concentration, and elevated market capitalizations have been well documented. Yet here we are, reflecting on the year that not many had predicted, the results of which are mind-boggling to us yet understandable within the context that inflation has been range-bound, the economy appears to be humming along and the labor market is surprisingly resilient. We all know this isn't likely to last forever but when it stops is anyone's guess. Within this context we are pleased with the SociallyResponsible's returns in the quarter and for the year. Any year in which this strategy can achieve double-digit returns we would call a successful one, even more so when you consider it was done without holding much of the stocks responsible for driving the market's concentrated returns.

While much has been said about this year's returns, little is being discussed about the other side of it—risk. The amount of money being spent on this AI arms race is phenomenal, yet investors will eventually ask for a return on their investment. Corporate balance sheets have ballooned as a result of the spending, yet it will eventually slow down and debts will have to be repaid. We do not believe the market is rationally pricing the companies participating in this race and therein lies the risk. The longer this rally continues, the more potential risk there is in the market. For the year, and to no one's surprise, the sectors that led the advance were either those that were participating in the AI arms race or those that were selling into it. Sectors like information technology, communication services, industrials and utilities were responsible for the market's robust returns for the year. Everything else lagged in this bifurcated market but the biggest laggards were in the consumer staples, health care, and real estate sectors.

The fourth quarter of the year wasn't much different. Information technology and utilities continued to lead the advance to close out the year with the exception that stocks in the health care sector rebounded and were one of the strongest performing sectors in the quarter. For the SociallyResponsible strategy, stocks in the consumer discretionary and materials sector lagged the benchmark's holdings. Graphic Packaging Company declined in the quarter after a disappointing earnings report and a change in management was announced. As long-term investors we see this as a buying opportunity as the company's fundamentals are solid, industry capacity is being reduced, and the softness in its categories is temporary. In consumer discretionary, Kontoor and Genuine Parts Co. contributed most to declines in the sector yet like Graphic Packaging, we view the price declines as an opportunity to own more of these well managed companies. Other laggards in the quarter include AT&T and Hershey, which we purchased more of in the quarter, and a few healthcare companies including Dentsply Sirona and Labcorp. These stocks are being ignored in this frenzied state of the market yet are likely to hold up well during a market correction as their revenue streams are not very cyclical and valuations are reasonable.

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Stocks in the consumer staples and industrial sectors contributed most to relative returns in the fourth quarter. In the industrial sector, both Cummins and nVent contributed to returns the most. We trimmed the position in both of these stocks as they have performed very well during the AI capex boom. Both of these companies, along with a few others in the portfolio, have benefitted from the massive data center investment cycle as both sell into the data center, where Cummins sells generators and nVent sells cooling components. Both represent a small fraction of the overall cost to build a data center and aren't likely to be displaced, rather we believe that these lofty valuations anticipate this build-out to permanently increase their revenue profile whereas we don't necessarily believe this is permanent. When the build-out stops or even slows, we believe a number of companies whose valuations have skyrocketed over the last number of years are in danger of falling.

Other contributors for the quarter were American Express, Coherent, and Regeneron. American Express is a long-term holding and we have purchased shares over the years when they lag the overall market and such it is a top holding in the strategy. It is a well-run business that focuses on a demographic that provides stability in what is typically a very cyclical and often risky business—credit. By allowing other card companies and banks take on the credit risk associated with higher growth, American Express consistently outperforms its peers on credit metrics at the cost of slower growth. When the market is focused purely on growth its shares tend to lag and therefore create buying opportunities. Coherent's shares increased over 70% in the quarter due to the AI capex boom. Similar to nVent and Cummins, we trimmed our position on valuation. We also eliminated our holdings in Corning for similar reasons. As we mentioned earlier, the longer the rally in the overall market and in particular anything AI related, the higher the likelihood of a market correction. We remain attracted to the competitive positions of the companies we have been trimming and should valuations come back in we might even repurchase, but as investment managers our job is to manage risk and as such we believe it is prudent to continue to sell shares in companies whose valuations are suggestive of increased risk.

During the quarter we added to our holdings in NXP Semiconductors and Nike and initiated a position in Adobe. Adobe has been out-of-favor in this “everything AI” rally as the market is fearful that its products can be replaced by AI. Additionally, new competition from Canva and Figma has investors concerned it could lose market share. It is our belief that similar to Microsoft’s Office suite, enterprise users of Adobe are not going to switch to a consumer/retail product like Canva or Figma. While casual users might enjoy the free or low-cost pricing model of these competitors, it isn’t likely to be much of a threat to its enterprise business which is much stickier and more profitable. Additionally, enterprise users are much more likely to use the organic and third-party AI products that Adobe allows in its Photoshop suite than to rely solely on third-party models outside of Adobe. Regulatory and intellectual property theft are real concerns for enterprises that create content and these concerns aren’t going away. We believe that Adobe’s highly profitable business is entrenched with enterprises and will prove to be more resilient than what the market is anticipating.

Many of the portfolio actions during the quarter should reduce portfolio risk as it relates to AI. As mentioned, we cannot tell when a correction will happen, but we can continue to look for opportunities to position the portfolio in the best possible way for a range of market environments and potential outcomes. We will continue to keep a keen eye on the unpriced risk in the market while looking forward to the prospect adding to the roster of companies that meet the responsible value objectives of our clients and shareholders.

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