

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Value Strategy Plays Defense with “Win by Not Losing” Approach

THOMAS HIESTER, CFA, is a Portfolio Manager on the Investment Strategy Team at SKBA Capital Management. He also serves as a Senior Securities Analyst and is an equity owner of the firm. He is responsible for security analysis, industry specific research, and investment idea generation. Prior to joining SKBA in 2016, Mr. Hiester spent five years as a financial analyst at a private investment firm. He received a Bachelor of Arts in business management economics from the University of California at Santa Cruz. Mr. Hiester is a member of the CFA Society of San Francisco and the CFA Institute.

SECTOR — GENERAL INVESTING

TWST: What would you want readers to know about SKBA, your overall expertise and investment philosophy?

Mr. Hiester: SKBA is a boutique value investing firm founded in 1989 in San Francisco. We specialize in actively managed, large-cap value domestic equity portfolios. We manage two main strategies: *ValuePlus*, a dividend-focused strategy, and *SociallyResponsible Value*, a responsible investing strategy. They are available as SMAs, mutual funds, and through model delivery.

Our clients are mostly institutions, although we also work with private clients and financial advisers seeking differentiated value portfolios for their clients.

We have several guiding principles. One, we use a team-based process, not a star manager system. This ensures continuity over time and that our best ideas make it into the portfolios through debate.

Two, we are aligned with clients as all portfolio managers are invested in our strategies. We are also employee-owned, which we believe ensures alignment.

Three, we are disciplined value investors with an emphasis on downside protection. We don’t chase hot stocks, even if it means leaving some money on the table. We look for sound businesses that are temporarily depressed for one reason or another. We build portfolios of 40 to 60 stocks, with diversification serving as one of several risk controls.

Four, we pursue independent perspectives and approach consensus with healthy skepticism.

As active value investors, we believe security prices can deviate from underlying business value both on the upside and downside due to the market’s bouts of excessive optimism and pessimism. We seek to capitalize on these mispricings through our repeatable process, and we believe that a portfolio of out-of-favor stocks with low expectations is a prudent way to compound capital and generate income. This approach has served the firm’s clients well for several decades.

TWST: Would you talk a bit about the key differences and similarities between the *ValuePlus* and the *SociallyResponsible* strategies and portfolios, including in particular your ESG overlay?

Mr. Hiester: *ValuePlus* is our flagship strategy. It seeks both appreciation and dividend income. This strategy is all about three D’s: defense, dividends, and differentiation.

As for defense, the strategy tends to outperform our large-value benchmark in down quarters and bear markets. Long-term upside/downside capture ratios are compelling in our view. Importantly, this is not a bear-market strategy, and long-term appreciation is a goal, but it’s downside protection that enables this. It’s a “win by not losing” approach.

Regarding dividends, the strategy had a 3.1% yield as of 2Q 2026, which is well above the value index and broad market yields. We don’t pile into interest rate sensitive sectors like staples and utilities to generate this yield; we source income from all sectors. Dividends are very important to our investment process, as we use them to help identify valuation extremes with our Relative Dividend Yield framework, and to gauge a company’s through-cycle earnings power.

As for differentiation, *ValuePlus* has a high active share, which is a measure of overlap between a portfolio and a benchmark. Simply put, the portfolio looks different than the benchmark. The portfolio doesn’t currently hold any Magnificent Seven stocks that are prevalent in the market and value index.

ValuePlus holdings include a mix of household names, but also less common names. We’re willing to look outside of the benchmark and may own some ADRs with significant U.S. operations. Additionally, the portfolio’s valuation metrics are much cheaper than our benchmark.

The *SociallyResponsible Value*, or SRV strategy, was launched in the year 2000, building on SKBA’s experience with managing screened portfolios going back to 1990. The strategy’s objective is straightforward: capital appreciation through an active, mid-to-large-cap value approach. There is no formal dividend requirement, but the portfolio’s yield was 2.1% as of 2Q 2026.

What differentiates the strategy in our view are the value discipline and the thoughtful, judgment-driven approach to responsible investing. Our responsible investing approach starts with common screens: no tobacco, alcohol, gambling, weapons, or nuclear power. We then use in-house and third-party research to analyze ESG issues. We believe judgment matters here, and that ESG analysis cannot be reduced to scores. There’s too much subjectivity.

For example, there are numerous instances where the two major ESG rating companies will disagree with one another. Methodologies differ; conclusions differ. We don’t outsource our thinking to a score. Instead, we try to reconcile different viewpoints and apply our own forward-looking analysis. This is in contrast to many scoring methodologies that are often backward-looking. Good companies can become bad, or vice versa, so we try to identify those inflection points.

Good corporate governance is paramount. We want to avoid bad actors, and our view is that good governance leads to positive environmental and social practices. Economics matter; we won’t buy a green company if the economics aren’t there to support it. We’re also willing to buy reformers, which we define as companies with past transgressions that have since cleaned up their act, or are in the process of doing so. We don’t believe that exclusions necessarily limit return potential based on the results of the strategy.

TWST: How do you define or measure value? Is it simply a matter of “cheap stocks”?

Mr. Hiester: To repeat a word I used earlier, we define value as something that’s mispriced. We balance fundamentals versus valuations and look for situations where the market may be underestimating value in the context of our typical three-to-five-year investment horizon.

Of course, we like low p/e stocks, and portfolio valuations are cheaper than the benchmark. Those characteristics are important to us. But we don’t want to be constrained to buying only one type of stock.

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Some stocks are cheap for a reason, and a low p/e doesn’t always make a good investment. We will own some securities with higher p/e ratios when justified by fundamentals, such as **CME Group** (NASDAQ:CME), which has higher gross and operating margins than **Microsoft**.

Compounders, or companies with consistent earnings growth, will sometimes trade at reasonable valuations, especially on a multi-year perspective when they are cheaper than they may initially appear.

We’re also willing to allocate part of the portfolios to turnarounds. These companies may have struggled to grow, but have credible plans to improve their businesses, yet the market may be uncertain about their prospects. We may lean into these situations when compelling. Again, our time horizon allows us to be patient.

We will also allocate to companies that may have more modest growth expectations but plan to reduce debt, resulting in higher equity values. Here, returns are more balance-sheet-driven than income-statement-driven. This was part of the attraction to **Solventum** (NYSE:SOLV), a holding in the SRV strategy.

The common thread is that companies are out of favor at the time of purchase, and we have the benefit of time to capture earnings growth or balance sheet improvements. We’re not really investing for quarterly “beats.”

1-Year Daily Chart of CME Group Inc.

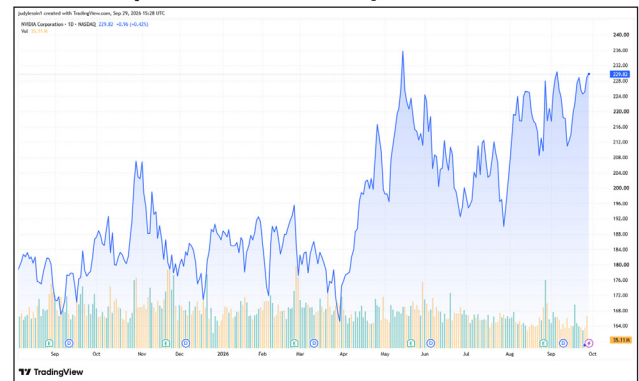


Chart provided by TradingView

TWST: Is there anything you’d add in terms of what differentiates your investment process and evaluation of potential holdings?

Mr. Hiester: Yes. Relative Dividend Yield, or RDY, has been the cornerstone of SKBA’s investment process since the firm was founded. Instead of looking at a stock’s absolute yield, we compare it to a proprietary universe of dividend-paying companies and plot this on a chart to see RDY over time. A high RDY informs us that the market has become pessimistic on a company relative to its own past and relative to peers, which is where we often find opportunity.

To be clear, RDY is not a mechanical buy or sell signal. Rather, it’s an initial valuation framework that identifies opportunities for further fundamental analysis.

We rely on dividends for a few reasons. One, dividends are a useful signal of long-term earnings power. Consider that corporations set dividend payments informed by long-term potential. In contrast, short-term reported earnings are often more volatile and less indicative of the long term. Two, dividends help identify valuation extremes through RDY that other valuation screens might miss. Three, dividends provide income, dampen volatility, and contribute to total return.

For non-dividend-paying companies, we use a metric called Relative Market Cap to Revenue, or RMCR. This applies the same logic as RDY, but effectively uses relative price-to-sales instead. The goal is the same: identify when market expectations for a business are depressed relative to history, which is where mispricings often occur.

Between RDY and RMCR, we have consistent and repeatable frameworks to identify opportunities, whether or not a stock happens to pay a dividend.

TWST: Where have you been seeing your biggest contributors this year, and do they point to any theme or trend?

Mr. Hiester: For *ValuePlus*, several energy holdings such as **Phillips 66** (NYSE:PSX), **ConocoPhillips** (NYSE:COP), and **Chevron** (NYSE:CVX) are top contributors this year. Geopolitics have been a key driver.

Energy stocks rose sharply in the first quarter as the Iran conflict began, and we trimmed on strength. Energy lagged in the second quarter on the prospect of a peace deal. Now in the third quarter to date, the conflict continues and energy is a top-performing sector again, like it was earlier in the year. It has helped to maintain our exposure, and we have trimmed again given the sharp rise in the stocks.

The situation remains fluid and uncertain, but break-even prices for our upstream-oriented holdings are far lower than current levels, meaning these businesses should continue to generate strong cash flows for shareholders even if energy prices revert to pre-conflict levels.

especially after the AI selloff in July rattled some investors and had them seeking alternatives to the AI trade. Relative to the benchmark, we’ve been overweight all year, and this sector remains among the top overweights in both strategies.

Kontoor Brands (NYSE:KTB) is one last contributor. There’s not as much of a theme or trend here; it’s more of a matter of differentiated, fundamental stock picking. This company makes Wrangler jeans, and recently divested its Lee brand and acquired Helly Hansen outerwear to improve its growth and margin profile. The business has low capex requirements and generates a healthy amount of free cash flow.

At roughly \$4 billion, this stock is a bit smaller in market cap and is not held by the benchmark. It represents some of the differentiated holdings we’ll add in select cases, although the portfolio characteristics remain firmly in large-value territory.

TWST: How about on the detractor side? Where are you seeing the biggest challenges, and are you exiting or trimming in response?

Mr. Hiester: First, I’ll mention that when our stocks decline, we reassess whether the issues are temporary or permanent. We may add or exit depending on that review.

“[Healthcare Realty] also cut their dividend, which we were actually rooting for. How often do you hear of dividend managers wanting dividend cuts? In this case, it made sense for the company to free up cash to invest in redevelopment, and the resulting dividend was still attractive on an RDY basis.”

Technology holdings have also done well this year in both strategies, including **NetApp** (NASDAQ:NTAP), **Cisco** (NASDAQ:CSCO), and for *ValuePlus*, **Texas Instruments** (NASDAQ:TXN). These are not AI high-flyers, but they have benefited from the data center buildout.

1-Year Daily Chart of Kontoor Brands Inc.



Chart provided by TradingView

We’ve owned them for several years, having bought them at much cheaper levels as we liked their solid cash flows and competitive positions. As the stocks have appreciated, we have recently trimmed on strength. Relative to the benchmark, IT is by far the largest underweight in both strategies.

Healthcare has been another bright spot, particularly in recent months. Part of the theme here is sector rotation or market broadening,

For example, in 2022, we added to **Royal Philips** (NYSE:PHG) after the stock fell following initial purchases. Based on our assessment, the stress it suffered from supply chain and product recall issues were temporary. This worked out well, as we successfully exited the position earlier this year.

I should also mention our sell discipline. For simplicity, our CIO likes to say either we are right or we are wrong. If right, the thesis plays out and the stock reaches fair value. We may be wrong if fundamentals continue to deteriorate, issues appear more permanent than temporary, or capital allocation moves in a direction we don’t agree with.

With that backdrop, the largest detractors this year include **Nike** (NYSE:NKE), **IBM** (NYSE:IBM), and **Graphic Packaging** (NYSE:GPK).

Nike is a turnaround situation that we have owned for about a year. Frankly, we were early, yet we still see value here and are going to give it more time. There are green shoots in the U.S. While China will take longer, we expect declines there to stabilize, at which point the company can grow again.

We’ve owned **IBM** since 2021. It’s done well for most of our holding period, and we’ve trimmed along the way. But it has struggled this year, especially relative to other parts of tech that have done exceptionally well. The stock declined after a disappointing pre-announcement where they reduced top-line guidance from plus 5% to a range of 4% to 5%. This indicated to us that expectations were a bit high, but fundamentals are still moving in the right direction and we continue to hold.

We’ve owned **Graphic Packaging** for almost a year and expect to exit the position, as the company has been impacted by factors outside of its control.

Our initial attraction was simple: The company was shifting from a cash outlay period to a cash harvest period following the completion of its new recycled paperboard mill in Waco, Texas. However, this plan has been interrupted by pricing pressure across both virgin fiber and recycled paperboard products, as well as by cost inflation.

The company is reducing costs as an offset, but these steps do not appear meaningful enough as its leverage profile has deteriorated. We see better use of this capital elsewhere within the sector.

TWST: I know you’ve just mentioned a number of companies, but are there any other holdings that you want to highlight?

Mr. Hiester: I’ll mention two of our top 10 holdings as of quarter-end and one newer holding.

First is **Healthcare Realty Trust** (NYSE:HR), a medical office building REIT, which I think is a good example of our differentiated perspective. We were drawn to the supply and demand dynamics in medical office buildings given limited new supply and positive absorption. At the same time, this company was out of favor after it acquired a competitor, and its balance sheet had floating rate exposure during the rate hike cycle in 2022 and 2023. They also had some tenant retention issues.

“Across the board, much of the market is concentrated in a handful of securities. The value index looks like growth, as do many active value portfolios, in our view. I’d encourage your readers to look under the hood and make sure their value exposure represents the value they are looking for.”

We initiated the position in early 2024. Since then, the company has taken several positive steps. They brought on a new CEO and refreshed the board. They sold assets to clean up the balance sheet. They shifted some leasing operations from in-house to external to help with retention.

They also cut their dividend, which we were actually rooting for. How often do you hear of dividend managers wanting dividend cuts? In this case, it made sense for the company to free up cash to invest in redevelopment, and the resulting dividend was still attractive on an RDY basis.

The fundamental trajectory of this company has improved, and we continue to hold as valuation also remains attractive.

Next, I’ll mention **3M** (NYSE:MMM). We’ve owned it in the past, but the recent holding period started in mid-2024 when we started buying around \$100 per share. Interestingly, it has some parallels to **Healthcare Realty**. What do a real estate company and an industrial company have in common? Well, **3M** also brought on a new CEO, cut its dividend, and shed assets to raise cash — in this case, by spinning off **Solventum**.

The company also settled a large portion of its environmental lawsuits, which reduced a key source of uncertainty. A key difference from **HR**, however, is that with **3M** these steps occurred before we bought instead of after. The market was not giving the company credit at the time, and we saw an opportunity to invest before these actions were fully reflected in the stock. We also view Bill Brown as one of the better CEOs across our portfolios, following a prior successful investment in **L3Harris Technologies**, and now again with **3M**.

ADP (NASDAQ:ADP) is a newer stock initiated in both strategies during 2Q 2026. **ADP** has raised its dividend for 51 years and has built a dominant, deeply embedded position in payroll and human capital management, serving 80% of the Fortune 500.

We think of **ADP** less as a simple service company, and more of a provider of what we’d call compliance-as-a-service. Payroll and tax withholding, for example, are key functions that enterprises cannot get wrong, which is reflected in retention rates north of 90% for **ADP**.

At initiation, the stock was down roughly a third from its 2025 highs on fears of a cooling labor market and that AI could structurally shrink demand for its services. We liked that management raised guidance even as the stock declined. This looked more to us like a sentiment-driven selloff than a deteriorating business. **ADP’s** pricing model also isn’t strictly linear with head count, providing some cushion if hiring stays soft.

We also like the float dimension of the business, which generates income for **ADP** from the funds it holds for clients. This appeared underappreciated by the market at the time.

ADP’s RDY was also near its highest level in over a decade, and the stock traded at a meaningful discount to its historical p/e range. Since then, the company has raised guidance again, the stock has partially recovered, and we continue to hold.

1-Year Daily Chart of 3M Co.



Chart provided by TradingView

TWST: As you know very well, the market really focused for some time on all things AI and growth and large caps. But value certainly has gained ground. How would you describe the overall market environment right now, and what’s your outlook for the foreseeable future?

Mr. Hiester: I think it’s important to dig into just how extraordinary recent returns have been due to the AI boom. The Russell 1000 Value Index returned over 14% in the second quarter; 10% of the 14% came from technology stocks. The top five contributors, all from tech, returned 200% on average. The average tech stock in the index returned 80%. These are highly unusual figures.

For context, we looked back at periods where the index returned 14% or more in a single quarter since firm inception in 1989. We then broke up those periods into two buckets: rebound periods following prior declines, and non-rebound periods. There were only two prior non-rebound quarters, which occurred in 1997 and 1998 in the lead-up to the dot-com bust.

That probably tells you a lot about our outlook. We don't expect these types of returns to continue. We are cautious on the AI trade that has supercharged the market. We don't profess to know when, but we do think the pendulum will turn at some point.

For now, hyperscalers still appear to be increasing capex, and estimates for 2027 suggest \$1.3 trillion worth of spending, up from about \$800 billion in 2026. Yet, much of this is funded with debt, and the recent backup in bond yields just increased the cost of borrowing casting more doubt on how long this can continue. This is also mostly speculative building; we have yet to see a compelling case for where the ROI will come from.

Much ink has been spilled elsewhere about the circularity among LLM companies and hardware suppliers, but one related data point is that OpenAI has committed to spending \$750 billion through 2030. Yet, their Q2 revenues were under \$7 billion. This is a wide gap to bridge that will require substantial financing.

We already saw a hiccup with AI stocks in July, but following the recent rebound, many AI-related securities are once again priced for perfection.

Despite these risks, we are encouraged by the environment as active value investors. The more the market concentrates on a small subset of companies, other areas get neglected and trade at out-of-favor valuations, like the healthcare sector did for so much of the year.

Should the pendulum swing the other way and the AI trade unwind, this would widen our opportunity set even further. Our differentiated value positioning should also leave us less exposed to an unwind as well.

TWST: Is there anything else you want to discuss, or any final advice to wrap up with for our readers?

Mr. Hiester: We are in a frothy market by many measures. At the same time, we see a lot of false diversification out there that I'd caution your readers about.

Suppose an investor buys the S&P 500 for a diversified, broad market exposure. There are supposed to be 500 stocks in there, right? Well, there's historically high concentration in a handful of securities and those stocks trade at expensive valuations. Historically, high multiples suggest lower prospective returns.

Now suppose an investor buys a large value index seeking diversification. Well, at the end of August, the number one, two, and three top weights in the Russell 1000 Value Index were **Amazon**, **Apple**, and **Microsoft**, which are the number two, three, and four weights in the S&P 500. Two of them are also in the top five of the growth index. We think this overlap points to higher correlations and less diversification benefits from the value index going forward.

Lastly, suppose an investor buys an actively managed large value fund seeking differentiation from the value benchmark. Well, many active funds hold these same stocks, often with significant weights in an effort to keep up with or even outperform this bull market.

Across the board, much of the market is concentrated in a handful of securities. The value index looks like growth, as do many active value portfolios, in our view. I'd encourage your readers to look under the hood and make sure their value exposure represents the value they are looking for.

In our case, we're comfortable knowing that our portfolios avoid this concentration risk, have lower valuations, and are built on a solid foundation of sound companies with reasonable expectations. As one of our founders used to say, boring is beautiful.

TWST: Thank you. (MN)

THOMAS HIESTER, CFA
Senior Securities Analyst & Portfolio Manager
SKBA Capital Management, LLC
(800) 989-7852
www.skba.com

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