4Q 2024
Value*Plus* Portfolio Review

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We find January to be an entertaining time of year, especially while reading market pundits' usual predictions of 8-10% returns for the year to come. One strategist might be an outlier on the low-end while an economist might be on the high end; in such cases said experts are likely more driven by the desire to distinguish themselves than by history. The 8-10% range is slightly higher than annual market returns over extended periods, suggesting that consensus suffers from two conditions: the first being blind optimism and the second being an unwillingness to stray too far from the norm. Yet it should be noted that market returns rarely ever return between 8% and 10% in any given year.

On the back of two consecutive years of returns in excess of 20% for the S&P 500, consensus expectations for 2025 have now been ratchetted up to 14%! Given humans' natural tendency to extrapolate, we are not surprised. It should nonetheless be pointed out that when such pundits predict a 14% gain for the S&P 500, what they are really saying is that the seven or eight largest companies will continue to outpace the rest of the market. How the remaining 492 constituents perform bears little weight.

Outside of initiating one healthcare position, changes during the quarter were fairly muted. Much has been written about weakness in healthcare over the last few years. Some of this is undoubtedly a result of the Covid hangover, product and service demand, bottlenecks, and subsequent reversals. More recently, the incoming administration's healthcare appointments have also cast a pall on the industry. With so many headwinds, it is no surprise that stocks in this sector have performed poorly. There have been a number of exceptions, however, and not simply limited to GLP-1 standouts such as Eli Lilly and Novo Nordisk. We took price strength in Cardinal Health and Royal Philips as opportunities to trim our positions. Both of these companies had been weak for idiosyncratic reasons—legal payouts due to the opioid crisis, product recalls and the like. As such issues were successfully addressed, the companies' stocks rebounded along with valuation levels.

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Dentsply Sirona, the lone new holding initiated in the quarter, can be said to be positioned today where Cardinal Health and Royal Philips were not too long ago. Its issues are fixable and operational discipline is currently the most important pre-condition for a successful turnaround. As a global market share leader within the dental industry in what are typically oligopolistic markets, most of the company's improvements are within its own control. Dental markets tend to be relatively stable with demographics contributing to additional tailwinds. The company should be able to grow its organic revenues more quickly than GDP as operating discipline with the potential elimination of less profitable units could improve margins. The company's dividend yield is currently 3.5%, a dividend which has grown nearly 10% per year over the last few years and the flywheel of excess cash flow return to shareholders will likely result in possible share buybacks and debt reduction, both adding to per-share financial strength. Dentsply Sirona is decidedly not among the Mag Seven or Eight, as the dominating large cap group is known, but its potential over the next few years is as attractive in our opinion.

We continued to add to our bank exposure over the last few months based on the improving landscape. Given our value-oriented proclivities, we added to U.S. Bancorp and Truist Financial, two significantly out-of-favor banks which we know well from our prior ownership. Just as parallels can be drawn between Dentsply today and Cardinal Health a few years back, parallels can also be drawn between U.S. Bancorp and Truist today and Wells Fargo not so very long ago. The two banks suffer from investor neglect more than anything else while they each also have internal issues they need to work through. None of these are insurmountable, in our view. A more munificent landscape combined with the ability to integrate acquired units should result in many of the same milestones being within reach. Shares of Wells Fargo have doubled over the last two years. It is not impossible for either U.S. Bancorp or Truist to exhibit similar returns over our holding period.

Besides reductions in some of our healthcare positions we also reduced Kontoor Brands, itself very similar to previously mentioned holdings, albeit in very different ways. The similarities revolve around the company being able to control its own destiny and being prudent from a strategic and financial standpoint. We don't need our companies to become great, although that is always a desire. We simply need them to become good, to improve their current standing and to be aligned with shareholder interests. When we see such improvements, we want to own them for years. Kontoor has been owned for approximately five years. We initiated in 2019 and added on weakness in 2020 at prices four to five times lower than the current quotation. During the earlier share price decline and given the healthy cash flows, we received dividends much larger than the overall market at very depressed valuations. Today, we cannot say that shares remain undervalued and have therefore meaningfully reduced our position. While Kontoor was one of our largest positions not very long ago, it is now simply average in size. Its fundamentals are just as strong, if not stronger, than they were yet its valuation has also meaningfully increased. Prospective returns are therefore lower.

The quarter was not kind to historically defensive sectors: utilities, REITs, consumer staples, and healthcare. They figured prominently among the weakest groups. The reasons are many and not always aligned with logic as much as with animal spirits (or the lack thereof in this case). Utilities had been one of the best performing sectors coming in to the fall and it can be argued that profits were taken in an industry that is typically slow growing and interest sensitive. REITs fall in one of two categories: those that benefit from everything and anything AI, and all the others. Consumer staples were not cheap to begin with and given the Covid hangover tied to excessive price increases, their lackluster showing is not particularly surprising. Healthcare's recent travails have often been discussed in these pages. Of the four sectors we are most interested in healthcare as the combination of valuation and fundamental attraction appears most compelling.

Consensus expectations of 14% on this year's market return may be as high as we've seen in the last twenty-five years, and we should all remember what happened next. We are not in the business of prognosticating market returns for flighty fame and fortune but of investing in companies that can realistically achieve many small milestones and return

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those fruits to us as shareholders. We would nevertheless suggest that this consensus borders on irresponsibility and is highly subject to disappointment. We will distinguish ourselves by continuing to manage prudently and with a time horizon that is more aligned with those of our clients and fund shareholders.