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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Generating Dividend Yield That's Not Correlated to Interest Rates

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SECTOR — GENERAL INVESTING

TWST: We spoke about a year ago, but would you give us a refresher on SKBA's overall business and investment approach and philosophy?

Mr. Segura: SKBA Capital Management is an independent boutique asset management firm based in San Francisco and was founded in 1989. We are employee owned, with a singular focus on discovering undervalued investment opportunities not yet realized by the market.

We currently offer two mutual funds based on our Value*Plus* (BVPIX) and Socially*Responsible* (BVSIX) strategies, where Value*Plus* is the dividend-oriented large-cap value strategy and Socially*Responsible* looks for undervalued opportunities within a responsible investing framework.

We believe that the market routinely overshoots on both the upside and the downside, which creates opportunities for disciplined, active managers over complete market cycles.

Our disciplined approach is underpinned by our team-based portfolio management, where we look to achieve consensus on actions taken within the portfolio, rather than relying on one star manager.

This helps achieve several goals. One is to ensure checks and balances within the portfolio management process, and the other is to ensure consistency over time and that our process is enduring.

All of our analysts are responsible for a cross-section of industries and sectors. We don't believe we need to be specialists; rather, we think it's more important to have a wide breadth of coverage to encourage big picture thinking. Furthermore, there is some crossover in sectors that does create a difference of opinion in some cases, which we find encourages debate and aids in the consensus-achieving process.

TWST: What else do you feel differentiates the Value*Plus* investment strategy?

Mr. Segura: Our overall investment philosophy and approach has several differentiators. An easy acronym that we use to think about our philosophy is 3D investing. The three Ds are: different, dividends, and defensive.

Starting with different, we're active managers and we can be very different in stock selection from benchmarks and peers. We tend to have high active share, and we use a relative dividend yield framework, which we pioneered, as a starting point within the process, which we don't believe anybody else uses, at least not in the way we do.

Moving on to dividends, dividends are a very important part of our process. We use them to help identify valuation extremes of individual companies, and as an insight into what management believes its normal earning power is. Also, as one can infer by looking at our returns, the process we use helps generate income that importantly is not correlated to interest rates. We can discuss more about this later if we have the opportunity.

The third D, defensive, relates to the record of downside protection achieved by our Value*Plus* and Socially*Responsible* strategies over time. Through this downside protection and upside participation, we've historically generated better-than-benchmark returns since inception with lower risk.

The Baywood Value*Plus* Fund (BVPIX) follows the same Value*Plus* strategy that we manage for our separately managed account clients and model platforms, and we've made it easy for retail clients to buy as well, because we removed the 12b-1 fees by creating an institutional class, and we lowered the minimums to retail levels.

This fits within our three-leg approach of offering strategies through separately managed accounts, mutual funds, and model delivery platforms like Envestnet and LPL.

TWST: In terms of income, what specifically are you looking for in terms of dividends? Is it growers? Something else?

Mr. Segura: I'd say something else. Dividend growth is not a necessary component for our holdings. We like dividend growth, but it's not necessary for our investment process.

We believe the way we look at dividends is very different from our peers. The process starts with a relative dividend yield framework, which compares a company's current dividend yield relative to a universe of 500 other top dividend-paying companies, adjusted to ensure consistency and also over time. This helps us identify when a stock is out of favor compared to the universe and to itself over time. In contrast, we think that there's no informational value at all in the absolute yield of a stock.

We're not just interested in purchasing dividend yielding companies without understanding the business value, so once the opportunity is identified, we begin our fundamental analysis process. If we confirm the value that the process identified, then we consider the company for inclusion in the portfolio.

As I mentioned, it's important to note this process, which SKBA has executed consistently since 1989, generates dividend yield that's not correlated to interest rates.

the Fed was going to have to cut interest rates, as it appeared to be evidence that it had gone too far in raising rates too fast. Furthermore, investors were assuming that banks in general would cut back their lending due to the turmoil, thus reinforcing the market's view that the Fed would lower interest rates.

The second was a rise of artificial intelligence in the collective minds of investors. This was prompted by **Nvidia's** (Nasdaq:NVDA) amazing stretch of growth and the widespread adoption of ChatGPT.

These two factors, from our perspective, swung the market's favor back to growth, as investors now had hope that low interest rates would support higher valuations, and the sales of all things related to artificial intelligence would support those higher valuations.

This phenomenon continued throughout the year, and the same market leaders that drove the indices in the years of the Fed's zero interest rate policy regained their momentum and led the indices back up again.

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We haven't been attracted to many companies in those aforementioned sectors in a while, because as they became beneficiaries of the Fed's zero interest rate policy they also became bond substitutes. This suppressed their dividend yields as investors placed high valuations on what we believe are very staid if not poor fundamentals.

So we've been rewarded by not owning many of the companies in these sectors over the last several years. As the Fed raised rates, a number of these, including companies in the real estate sector as well, have been some of the worst performing stocks in the market, which also confirms their bond-like correlations.

As equity investors, we believe it's important that equity behaves like equity and not like bonds. If investors wanted more bond-like exposure, we believe they'd do so by purchasing bonds, not equities. This relative dividend yield process helps us avoid looking like a bond substitute.

TWST: Can you discuss what some of your best performers were last year, whether individual stocks or just in terms of sectors and themes?

Mr. Segura: I'll start off thematically, and then drill down, if you don't mind. Last year was an interesting year from our perspective. Considering how awful the market was in 2022, we assumed there would be a rebound, but we didn't think it was going to be one of such magnitude. There were several factors that led to the resurgence of interest in growth stocks last year that I don't believe many would have predicted.

One was the two largest bank failures since the financial crisis that occurred early in the year. This led investors to believe that

The reason why I say this is because one might naturally think that, given the bounce back in the market leaders and the ever-increasing concentration of those top seven stocks, that there'd be little opportunity for much else to perform well.

1-Year Daily Chart of Kontoor Brands Inc.

Chart provided by www.BigCharts.com

And while much of this is true, we were still able to pick a number of stocks that performed very well last year. In fact, when you consider that Value*Plus* performed as well as it did in 2022, being up nearly 5% when all the indices were down, that it also outperformed the benchmark again in 2023 is a testament to the number of opportunities in the market.

There were headwinds, for sure. Being value managers and having a dividend requirement meant that none of the market leaders last year, like **Meta** (Nasdaq:META), **Alphabet** (Nasdaq:GOOG), **Netflix** (Nasdaq:NFLX), were a good fit for our portfolios.

Yet stock picking more than made up for the absence of those stocks, and while most of the relative return managed came from our holdings in health care, strong returns were mostly broad-based. Stocks like **Kontoor Brands** (NYSE:KTB), **Royal Philips** (NYSE:PHG) and **Parker Hannifin** (NYSE:PH) were all up more than 60% for the year. **Radian** (NYSE:RDN), **NetApp** (Nasdaq:NTAP) and **NXP Semiconductors** (Nasdaq:NXPI) were up more than 50%. New holdings in **FedEx** (NYSE:FDX) and **Charles Schwab** (NYSE:SCHW) were up more than 30%.

1-Year Daily Chart of Koninklijke Philips NV

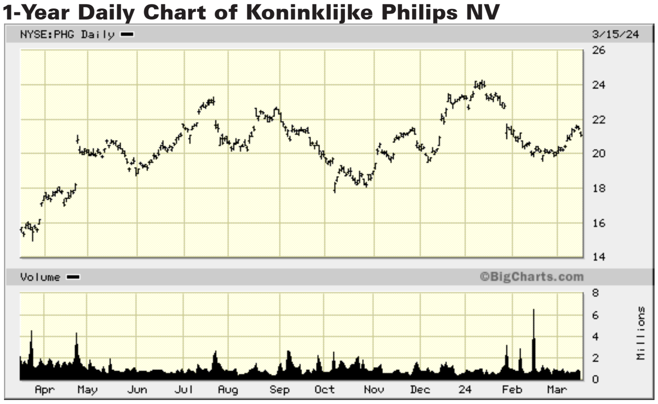

Chart provided by www.BigCharts.com

These represent a broad cross section of sectors — consumer discretionary, industrials, financials, health care and information technology.

Some of these companies we've owned for some time, as a combination of valuation attraction with fundamental attraction has allowed us to build positions over time.

Royal Philips is a little different in that we've owned this company before. It primarily operates in an oligopoly of health care equipment, along with **Siemens** and **GE**. When we owned it before, we sold out around $60 a share several years ago. But more recently it ran into some manufacturing quality issues and supply chain problems.

Like most reactions related to the pandemic, the market was overly pessimistic on **Royal Philips**, and we were able to purchase a company near an extreme low valuation and a high dividend yield. We didn't purchase **Phillips** at the onset of the pandemic, rather this one took several years to finally hit bottom.

Radian is a mortgage insurer that operates in a highly regulated industry, and due to recent regulations, it's nearly impossible for a new entrant to start in the industry. **Radian** earns high returns on capital and is the best operator in the mortgage insurance industry, in our opinion. It's one of the many companies that we hold in the financial sector that is not a bank, which we consider carefully curated for this sector and very differentiated from our peers and benchmarks.

TWST: Are you expecting similar types of companies to perform well or be attractive this year, or have you changed your focus at all in 2024?

Mr. Segura: Our focus in 2024 is a little bit different than it was last year. We've increasingly added — carefully — to companies that may be a bit more defensive in nature. Again, we have to be careful, because a lot of classic defensive sectors like health care, consumer staples, utilities, they had become bond substitutes, like I mentioned before.

So, we look for opportunities a bit more carefully in these sectors. And we've found a few, and we recently added a number of these companies to the portfolio. At the same time, we've also been able to sell out of some of our better performing socks we've held over the last two years.

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These are companies like **Kontoor Brands**, which owns Lee and Wrangler Jeans and operates an incredibly efficient business model with very low capital requirements and generous shareholder returns. **NetApp** is also a long-term holding. It has successfully converted its business model from a legacy IT storage company to a cloud service provider under the impressive stewardship of CEO George Kurian.

A number of those companies we also added during the selloff that occurred early in the pandemic, when they were selling temporarily at a fraction of what they are today. These include companies like **Parker Hannifin** and **Radian**.

Parker Hannifin is a high-quality industrial that rarely trades at both valuation multiples and a high enough dividend yield to consider owning. And while a crisis is never something to hope for, when they occur and the market overreacts, we can take advantage of opportunities like these to own high-quality companies at very reasonable prices.

Strategically speaking, we do think that valuations from a broad market perspective are still pretty high, and yet we think that there's a lot of volatility out there in terms of what the market favors.

There has been this seesawing back and forth whereby the market is trying to anticipate when the Fed's going to cut rates and which types of stocks are going to do well under which scenario. Then inflation doesn't go down as much as expected so all the money goes back to another set of stocks.

We try to look through all of that when we're looking at individual companies for our portfolio. But, overall, we try to take the opportunities that are presented to us, and at the same time, keep our heads on straight about where we are in the cycle and what's going on beyond that.

TWST: You mentioned you added a few companies to the portfolio recently. Can you tell us about some of these investment ideas and why they're attractive for your strategy?

Mr. Segura: Yes, absolutely. I just want to quickly back up and speak about the financial sector, one of the top weights within our portfolio, and how it is composed of very different holdings than our benchmarks and peers.

We're not currently attracted to many banks, and I'll just leave it at that for now. But we are interested in things like commercial property casualty insurance, select life insurance companies, and mortgage insurance, such as **Radian** mentioned earlier.

Within property and casualty insurance, we like **AIG** (NYSE:AIG). **AIG** is not a new holding, but there is a reason I bring it up. **AIG** has been undergoing a massive restructuring for years, really since the financial crisis 15 years ago. It's had several CEOs in this time frame, from Bob Benmosche to Brian Duperreault to the current CEO, Peter Zaffino, all of which have streamlined **AIG's** business to be a pure property casualty insurer, which has been an industry with numerous tailwinds over the last five years or so.

"Kenvue is another company we're excited about right now. It's a spinoff from Johnson & Johnson that includes brands such as Band-Aid, Neutrogena, Tylenol and others. These are powerful brands that have very likely been underinvested in, and represents one of the lowest valuations and highest dividend yields of any consumer staple company currently."

The pricing environment has been strong, and is adequate for the first time in over a decade. Investment income is increasing off extreme lows, and valuations remain reasonable. **AIG** just completed the sale of its reinsurance segment, and is in the process of selling off the remaining parts of its life insurance business, which it IPO'd last year.

So, all of this capital that they're receiving, they're going to buy back shares, which is going to be well over 10% of its current market capitalization, and to increase its dividend, which it did by 12% last year.

There aren't very many companies right now with sound balance sheets, solid management teams, industry tailwinds, and generous amounts of capital to return to investors like **AIG** does.

Additionally, and this comes to the new position, **AIG** created an IPO for its life insurance business called **Corebridge** (NYSE:CRBG). It did so during one of the worst times to IPO a financial company, which coincided with the mini banking crisis early in the year.

We were early buyers following the IPO, recognizing the value inherent in a well-run life insurance company that was selling at a fraction of book value. As it declined, as most financial companies did last year, we continued to add to our position, and now it's one of our top financial holdings.

We believe that the lack of liquidity, because **AIG** was going to take time selling down their position in the company, was one of the main reasons holding back the valuation on this well-run company with a dividend yield in excess of 5%. As **AIG** continues to sell down its holdings in **Corebridge**, which it did throughout the year, and more and more liquidity is being provided to the market, it's likely to be more widely held, thus increasing its valuation and price.

It goes opposite to what a lot of books teach about liquidity, but we found, and we've seen this in numerous other cases, that a stock increasing in liquidity can actually give it a valuation premium that it deserves. We've been correct so far. We've been able to purchase a number of shares close to $16 a share, where the stock trades somewhere around $25 currently.

Corebridge is not alone in what we'd call this bucket of orphaned IPOs, or ignored spinoffs. **Kenvue** (NYSE:KVUE) is another company we're excited about right now. It's a spinoff from **Johnson & Johnson** (NYSE:JNJ) that includes brands such as Band-Aid, Neutrogena, Tylenol and others. These are powerful brands that have very likely been underinvested in, and represents one of the lowest valuations and highest dividend yields of any consumer staple company currently.

Part of this is due to the way in which it was spun out. Similar to **Corebridge**, it was not very good timing. Yet they were creative in how they floated nearly their entire stake in a $40 billion business, maybe because they knew spinoffs don't always work out great in the short term, or because of the market environment.

In any case, it really didn't work out for them, and the shares declined meaningfully. For investors like us, it seemed like a good opportunity to pick up an underinvested portfolio of brands at a discount.

1-Year Daily Chart of Radian Group Inc.

Chart provided by www.BigCharts.com

TWST: You mentioned a few minutes ago that you don't like banks at the moment. What's the reason?

Mr. Segura: For the banking industry as a whole, it's seen headwinds for a number of years by competition from non-banking lenders such as private credit. This is not really new information, but it's been one reason why we haven't really been that enthusiastic about banks in general.

Furthermore, every year the industry has to overcome increasingly burdensome regulatory headwinds to growth. They have to carry more and more capital, and requirements get more and more strict. It's been a political hot topic ever since 2008, 2009, and it's yet another headwind to the industry.

Those are structural headwinds, but there are cyclical headwinds as well. And when put together, it's just a little too much for us to be excited about. Loan loss provisions are increasing, net interest margins for the most part are either at peak or already declining, and their business is cyclical, so if the Fed slows down economic growth and achieves its objective at some point, then loan growth will slow as well. So, for those reasons, we have not been as interested in banks.

TWST: Are there any other sectors or industries that you're cautious about?

Mr. Segura: I'd paint with a broad brushstroke and say, not necessarily sectors or industries, but in general companies with high leverage are still an area of concern for us.

buckets: Either we are right, or we are wrong. In our business, it's impossible to be correct all the time. We're making decisions on incomplete information, after all. We simply look to be correct most of the time, and try to minimize the effect from blowups.

One of the ways in which we manage this risk is to set a limit on the size of any position to 5%. Another way is to make sure we don't get too concentrated in our sector exposure, so we limit the size of our potential sector exposure. We also tend to hold somewhere between 40 and 60 stocks, which we've found to be the sweet spot in terms of being active but not too concentrated.

If we get it right, then one of three conditions will likely be present: It reaches our price target, it exceeds our 5% position max target, or the stock gets acquired. If we got it wrong, then we'll likely see either deteriorating fundamentals, lack of shareholder orientation, or a better use of our investment capital.

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There's going to be a lot of refinancing coming up in the next year or two, where companies with little room for error will be forced to make some difficult decisions in the near future. That's to either refinance at higher interest rates and have your interest expense eat away at your profits and therefore your competitive ability — or default. Neither of these are great outcomes for companies with high levels of debt.

We believe the market initially had it correct when the Fed began to raise rates in 2022, and a lot of these highly levered companies sold off. And when the market began to anticipate that interest rates would be cut in 2024, the prices of a lot of these companies rallied, assuming that the high cost of debt wouldn't be so burdensome. But we would disagree.

You've heard me talk a little bit about capital allocation, how we like to reward companies with sound capital allocation practices. Well, the opposite can be said about companies with poor capital allocation practices. They may have been able to get away with high levels of debt when the cost of debt was essentially free, but we still believe there's going to be a reckoning for companies that have not managed their enterprises efficiently.

In addition, for most measures of the broad market, which are again at all-time highs, we think there is some risk to valuations if inflation remains stubborn in this 3% to 4% range and interest rates remain elevated. We witnessed this seesaw effect going on in the market since the Fed began to raise interest rates as to what the market is favoring and disfavoring, and we think we're near another point where the market could turn and valuations could come back down.

TWST: What characterizes your ongoing risk management and your sell discipline? Is there a recent example of exiting a holding or trimming back on a holding that you could tell us about?

Mr. Segura: Generally speaking, our sell discipline is relatively straightforward. I personally like to think about it in two broad

We tend to ask ourselves, fundamentally, did the company's financial profile improve over our holding period, and how has the market reacted? If we expected improvements and we received none, we're likely to sell. There's no hard and fast rule on the time frame we would expect improvements, but generally within a year.

1-Year Daily Chart of NetApp Inc.

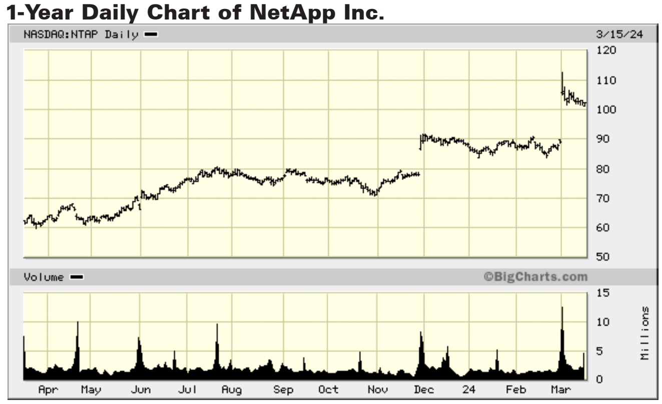

Chart provided by www.BigCharts.com

New management can also force a change in our investment thesis, so we tend to reevaluate our holdings after management changes. And capital allocation; if the capital allocation priorities change away from our desire, which tends to be to reward shareholders with excess capital and/or pursue prudent business combinations, then we'll reevaluate our holdings.

One example that comes to mind is one that I think few could guess. There is a large cap stock in the information technology sector that over the last two years had outperformed all but one of the Magnificent

Seven stocks, had a dividend yield in excess of 4%, and is growing its underlying business despite what appears to be a downturn in IT spending not related to AI. That would be **IBM** (NYSE:IBM).

IBM has been a top holding of ours for a number of years. Ever since they acquired Red Hat, they stopped buying back shares to pay down all the acquisition-related debt. They spun out their underperforming consulting businesses, and completed a major revamping of their business under the new CEO, Arvind Krishna, the kind of which they hadn't seen in a very long time, nearly 30 years.

We think it represents an underappreciated artificial intelligence opportunity, and we've been rewarded as shareholders with better performance than most IT companies over the last two years with much less volatility.

But having said that, the company did reach our internal price targets, where we don't think there's that much of a valuation opportunity going forward, and so we trimmed our holding recently to reflect that. It's still a large holding, but that's the risk management part.

Part of our philosophy is that when you're buying these undervalued companies and you're getting them at peak pessimism and very high dividend yields, there's just not that much downside left in the individual stocks when you're buying them at that right time.

But after a while, when the valuation increases and your fundamentals have gotten better and the market has clearly accepted that, then there may be some more downside risk than there was before, and that's when we start taking some off the table.

TWST: Has anything stood out for you in the latest quarterly earnings reports and management calls?

Mr. Segura: We're long-term investors, so we try not to put too much weight on what's going on in every quarterly call. Right now, all anyone can talk about is artificial intelligence, which to us is about 90% hype and 10% reality. It can certainly affect valuations if the market believes the company can somehow participate in that hype.

But as far as we can tell, most of the money is going to be made in the picks and shovels, for example, companies that have already seen a benefit to their top line, like **Nvidia**, they're the ones that sell the chips that most of these applications run on.

Other than that, we're always on the lookout for where we are in the cycle. Again, being long-term investors, we don't necessarily avoid companies that may be in a cyclical downturn, just as we don't reward companies unduly for being on a cyclical upturn. Rather, we look for changes in the environment which a company may not be prepared for, and how their financial structure might help or hurt their decision-making abilities.

As previously mentioned, for example, highly levered companies may do fine in an era of ultra-low interest rates and booming economic growth, but will get hammered if their interest expense soars and the economy turns.

TWST: To wrap up, how would you summarize your outlook for the next 12 months or so, and what advice would you offer readers right now?

Mr. Segura: For investors like us, we think the environment going forward is as good as any that we've seen in a while. I know that may sound odd, but when the markets focus on a few winners like it has been, a large swath of companies are often, and have been, ignored. Over time, by purchasing companies with low expectations yet good and growing business models that reward shareholders with dividends, our returns have historically been compounded and are often much less volatile than the overall market.

We think the volatility is only going to increase in the overall market, especially considering the concentration of the indices and the ever-increasing valuations. Similar to the beginning of 2022, we believe we're in a good spot with the companies we own, and we look forward to adding to our portfolio of quality companies trading at a discount.

TWST: Thank you. (MN)

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Investing involves risk, including potential loss of principal. There can be no guarantee that any strategy will be successful.

For standard Fund performance, please see the Baywood Fund Fact Sheet www.skba.com/baywood-funds.
Holdings are subject to change. For a list of current holdings, please visit www.skba.com/baywood-funds.
Before investing you should carefully consider the Fund's investment objectives, risks, charges and expenses. This and other information is available in the prospectus, a copy of which may be obtained from 855-409-2297. Please read the prospectus carefully before investing.
Baywood Funds are advised by SKBA Capital Management, LLC and distributed by Foreside Fund Services, LLC.

Glossary of Terms:

Socially Responsible Investing Framework: *SKBA believes that environmental, social and governance (ESG) factors often have long-term financial implications on a company's revenues, expenses and overall risk profile. By identifying undervalued opportunities where stock prices have overshot true changes in underlying fundamentals, SKBA seeks to generate alpha through disciplined, bottom-up research of responsible factors and company financials. SKBA's team-based process begins with the evaluation of both inclusive and exclusionary ESG criteria. Analysts then apply the firm's valuation framework to narrow the investment universe to opportunities reflecting low expectations discounted into current valuations. This subset is subjected to further in-depth fundamental analysis including both responsible investment considerations – that may include corporate governance, employee relations, environmental impact/sustainability, human rights record and product safety – and financial considerations that include earnings power, balance sheet and income statement strength, competitive position, and overall industry prospects. Aligned with SKBA's value philosophy, the team seeks to identify ESG improvers that it believes can offer the greater potential for a responsible investment, as well as a financial investment, for the firm's clients.*

Active Share: *A measure of the difference between a portfolio's holdings and its benchmark index.*

Dividend Yield: *The dividend yield is a financial ratio that shows how much a company pays out in dividends each year relative to its stock price.*

IPO: *Initial Public Offering*

Magnificent Seven: *Group of high-performing tech stocks: Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla.*