KERUSSO CAPITAL MANAGEMENT
US LARGE CAP VALUE
FIRST QUARTER 2023 REVIEW

Growing up as a child, I used to love when the Fall of the year would come. My family, friends and I would go to the fair. And, one of our favorite rides was a ride called the Himalayas. On the Himalayas, music would blast while this ride would take you backwards and forwards with shrieks and yells along the way. After the ride, people would come off a little disoriented and disheveled. And, for all the discomfort during the ride, quite frankly, everyone ended up at the same place…right where they had started. The only real difference, other than a possible upset stomach, was the passage of time. The first quarter reminded me of those Himalayas days – a lot of discomfort, the passage of time, and, from my perspective, still in the same place.

The failure of Silicon Valley Bank took some steam out of the market due to a run on the bank as long-dated holdings proved the reality of bond math, when yields go up, prices go down. The decline in bond prices reduces the value of assets which, due to banking regulations, requires the shoring up of capital. Raising equity capital can make investors skittish about the prospects of financial institutions and they can sometimes run. They ran from Silicon Valley Bank. The spillover effect raised concerns across the banking universe and caused the stock market to decline, primarily in the month of March.

Because of our exposure to Financials, which we increased at the beginning of the quarter, our overweight position proved less than helpful for the balance of the quarter, cutting our outperformance but not eradicating the lead that we had built over the previous two months.

So, from a performance standpoint, after the Himalayas ride, we were pretty much right where we had started the quarter…close to in line with our benchmark, the Russell 1000 Value.

First Quarter Review
For the quarter, 6 out of 11 sectors outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value. In terms of the performance that was generated, stock selection was the sole contributor with sector allocation lagging.

Performance for the Russell 1000 Value was balanced with six sectors outperforming – Communication Services, Technology, Consumer Discretionary, Materials, Industrials, and Real Estate. Despite the riskiness perceived in Financial Services, the market adopted more of a risk-on posture as the financial upheaval appeared to be a catalyst for a shortening of the Federal Reserve's path towards higher interest rates. Therefore, riskier assets with longer duration prospects came to the forefront of investor's appetites.

For the quarter, our portfolio was predominantly overweight Financials, Energy, Materials, and Consumer Discretionary. The most significant underweights were Health Care, Real Estate, Utilities, Technology, and Industrials. For Technology and Financials, a change in classification for two of our holdings, Visa and MasterCard, from Technology to Financials during the quarter,

caused Financials to be higher than after the quarterly adjustments in January and a lower weight in Technology. There may be a need for some correction when we make our quarterly sector adjustments.

The three sectors with the highest contribution for the quarter were Financials, Materials, and Health Care. In Financials, 14 out of 19 securities outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value. Basically, positive participation came from any holding other than the bank securities that were purchased at the beginning of the quarter – US Bancorp, KeyCorp, and Regions Financial. In Materials, 5 out of 5 holdings outperformed as concerns regarding a prolonged recession dissipated as the potential for a shorter Federal Reserve tightening cycle appears more likely. In Health Care, 6 out of 8 securities outperformed with the outperformance being led primarily by the underweight position of over 800 basis points that exists in the portfolio.

The sectors with the lowest level of contribution were Energy, Communication Services, and Consumer Discretionary. In Energy, 4 out of 6 securities underperformed the respective sector and/or the overall benchmark, the Russell 1000 Value, due to a decline in oil prices which OPEC+ has stepped into by recently announcing a production cut. In Communication Services, only 1 out of 5 stocks underperformed but the market's short-term interest in more Technology-related securities tied into areas such as social media caused our sector to be a laggard. In Consumer Discretionary, 4 out of 5 stocks underperformed as interest waned for holdings with more economic stability typically associated with them in lieu of those that might benefit more from an economic upturn.

The stocks with the greatest positive contribution were Apple (+27.11%), Oracle (+14.10%), Interpublic (+12.77%), Blackstone (+19.51%), and LyondellBasell (+14.46%). These stocks represent holdings from the Technology, Communication Services, Financial, and Material sectors. These stocks are representative of the more positive, pro-cyclical, risk-on posture that the market adopted for most of the quarter. Each stock is still a portfolio holding as we continue to view them as *Value Creating Opportunities.*

The stocks with the greatest negative contribution were Meta Platforms (+76.12%), ConocoPhillips (-15.02%), EOG Resources (-10.05%), KeyCorp (-29.03%), and AES Corporation (-15.77%). These stocks represent holdings from the Communication Services, Energy, Financial, and Utility sectors. Meta stands out because of the huge gain in the position with it still being the largest negative contributor due to our underweight position of the stock in our portfolio. Energy was challenged with declining oil prices while the well-known concerns with regional banks is evidenced in the performance of KeyCorp. AES is probably the most un-Utility like stock in the Utility sector and the performance often diverges from the other stocks in that sector. Each stock is still a portfolio holding as we continue to view them as *Value Creating Opportunities*.

During the quarter, four securities were sold – Franklin Resources in Financials, Eli Lilly and Viatris in Health Care, and Northrop Grumman in Industrials. Six new securities were purchased – American Express, Corebridge Financial, KeyCorp, Synchrony Financial, Regions Financial, and US Bancorp – all in Financials.

Overall purchases and sells resulted in the decrease in the Health Care and Industrial sectors coupled with an increase in the Financial sector. It must be reiterated that Technology decreased due to the change of classification of Visa and MasterCard but not due to portfolio actions. Any other changes occurred on the basis of capital appreciation and depreciation of individual securities.

All was related to our quest of seeking out *Value Creating Opportunities* for our clients.

Second Quarter Outlook

The positioning of our portfolio has not materially changed over the last few quarters with the exception of the increase in exposure to the Finance sector and the decrease in exposure to Health Care.

A way to interpret that is that our process is taking us into seemingly more risky areas while correspondingly decreasing exposure to a safer harbor.

In reality, our process, by combining valuation with fundamentals, always has us seeking after safe harbors with the vision that safe harbors is where the market should be going, not necessarily where it currently happens to be in terms of the pendulum of investor sentiment, optimism and pessimism.

We do not think the banking system or the Finance sector is about to collapse. Silicon Valley Bank was an exogenous shock to the system that should bring regulators and practitioners to the table to make sure our banking system is safe and sound. Valuations seem to reflect otherwise which we perceive as an opportunity.

Health Care has some great opportunities from a fundamental standpoint and, collectively, valuations reflect that. As a result, what seems safe on the basis of popular opinion presents greater risk from our vantage point.

Our contrarian approach is not to simply be contrary. Our pursuit is to find where opportunities are to be found. And, for them to truly be opportunities, we typically have to be there before others recognize what we can plainly see. That is how we have added value to client portfolios for over twenty years and plan to do so into the future.

This approach has us believing that the market has a wall of worry to climb that is well-known. Now, how to take advantage of that is the objective. We still believe that being tilted towards a scenario where economic growth is not as challenged as some prognosticators might suggest will

yield attractive returns and being too defensively positioned will not provide the expected protection that some investors may pursue.

The chaos of the current climate is creating opportunities. An approach seeking clarity through the confusion and chaos will win out. We expect for Kerusso to be one of the winners.

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April 6, 2023

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