KERUSSO CAPITAL MANAGEMENT
US LARGE CAP VALUE
SECOND QUARTER 2023 REVIEW

I imagine that some of you might remember the children's story and project called "Flat Stanley". Basically, with Flat Stanley, a cutout of a child's figure was made with a fictional character who had several details associated with it. Flat Stanley would then be sent to other people who would take a picture and tell a story about what Flat Stanley had been up to. Flat Stanley would then be sent back with another story to tell.

But, to keep it ever so real, no matter where Flat Stanley went, Flat Stanley stayed flat.

For this quarter, no matter what happened in the market, to our benchmark, or in our portfolio, we ended the quarter flat to the benchmark.

Was it exciting? Yes. Was it adventurous? Yes. Was it interesting? Yes.

But, at the end of the quarter, it was rather uneventful because we ended the quarter flat with the benchmark.

Now, just as others would take Flat Stanley joyfully, I am thankful for a quarter flat to the benchmark because I believe that it continues to reveal the strength of our investment process in a tumultuous while exciting, calamitous while adventurous, nerve-wracking while interesting quarter.

Let us explain.

Second Quarter Review

For the quarter, 5 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, sector allocation was positive while stock selection was negative with nearly the same amount of underperformance as sector allocation generated outperformance.

Performance for the Russell 1000 Value was balanced with five sectors outperforming – Communication Services, Industrials, Consumer Discretionary, Financials, and Technology. These sectors each had a measure of pro-cyclicality within them that had a strong deal of appeal in a market that believes that the Federal Reserve is closer to the end than the beginning of the rate hike cycle.

For the quarter, our portfolio was predominantly overweight Financials, Energy, Consumer Discretionary and Materials. The most significant underweights were Health Care, Real Estate, Utilities, and Technology.

The three sectors with the highest contribution for the quarter were Financials, Technology, and Consumer Discretionary. In Financials, 13 out of 18 securities outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value. For the quarter, in Financials, it looked pretty much like EBB (Everything But Banks) as all of our Financial holdings, with the exception of Goldman Sachs, had a positive return with the exception of the three banks that we own. In Technology, 2 out of 3 holdings outperformed as the sector generated a more positive response in the face of a potentially shallow recession and the possibility of a continuation of growth. In Consumer Discretionary, 5 out of 5 securities outperformed, in a fashion similar to Technology, by anticipating greater economic growth beyond the pessimism currently priced into valuations.

The sectors with the lowest level of contribution were Industrials, Health Care, and Communication Services. In Industrials, 5 out of 6 stocks underperformed as our holdings were less cyclically tilted than those that performed at a higher level. In the Industrials sector, harder cyclical stocks were favored in the anticipation of a turn in economic sentiment regarding the Federal Reserve behavior. In Health Care, 5 out of 6 stocks underperformed as the lower beta, less cyclical pharmaceutical holdings which dominate our portfolio in this sector sat out the stronger rally across the market and in the sector. In Communication Services, 3 out 5 stocks underperformed as the securities related to higher growth were favored over those with more stable albeit lower growth prospects near term.

The stocks with the greatest positive contribution were Oracle (+28.71%), Apple (+17.79%), Apollo (+22.43%), Discover Financial Services (+19.05%), and Moody's (+13.91%). These stocks represent holdings from the Technology and Financial sectors. With the anticipation that the Federal Reserve may slow down the pace of rate hikes, these sectors and the representative holdings benefited. 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 (+35.41%), AES Corporation (-13.31%), KeyCorp (-24.67%), UPS (-6.71%), and Abbvie (-14.69%). These stocks represent holdings in the Communication Services, Utility, Financial, Industrial and Health Care sectors. Similar to last quarter, Meta was the highest returning stock in terms of absolute returns but was the largest negative contributor due to our underweight position of the stock in our portfolio. The other securities were in sectors that were less correlated to the positive sentiment associated with the slowing of rate hikes although some of the banking related Financials were hindered due to the potential associated decline in the value of loan assets on bank balance sheets. Each stock is still a portfolio holding as we continue to view them as *Value Creating Opportunities*.

During the quarter, no securities were sold. One new security was purchased – Qualcomm in Technology.

Overall purchases and sells resulted in an increase in the Industrial and Technology sectors coupled with a decrease in the Financial sector. 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.

Third Quarter Outlook

The market is in a bit of a quandary. While economic growth appears to be solid, a Federal Reserve induced recession appears to be the expectation. The prospect of slower economic growth has the market in a tug of war between waiting for the Federal Reserve to stop raising rates and worrying that the economy may be in recession when it happens.

While the pace of rate hikes has many worrying, we believe that the froth associated with loose credit standards tied to essentially free or easy money needs to end. To that degree, we agree with the Federal Reserve raising interest rates.

The key question is, "When will the Federal Reserve have done enough?"

The current level of interest rates is still on the lower end of the historical curve; but, rising rates, no matter the level, removes levels of borrowers from the market. As such, a slowing economy is going to occur.

Inflation is likely to be more tepid as we move forward as demand begins to be more balanced with supply and should give the Federal Reserve the opportunity to move closer to the levels that can bring an end to the rate hikes.

Our current positioning is still a persistent tilt towards a pro cyclical stance. While that appears to be counter to what the Federal Reserve is doing, we believe that this news is already discounted in our holdings and our portfolio.

For these reasons, we lean on the discipline of our process which often has us positioned in contrarian ways to the market based on a combination of valuation and fundamentals.

We believe, as the market moves forward, this current positioning will prove to be prescient in how the market performs.

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