KERUSSO CAPITAL MANAGEMENT

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US LARGE CAP VALUE
THIRD QUARTER 2023 REVIEW

How many of you are rock climbers? I cannot count myself in that number although there is a structure that I have climbed consistently throughout my investment career which has spanned for nearly three decades.

I have dared to climb the proverbial wall of worry.

The wall of worry in the stock market is daunting and not for the faint of heart.

Many like to talk about it but true investors dare to be about it, climbing the wall of worry.

In the most recent quarter, we made another step up the wall as we maintained a position of pro-cyclicality while those who like to talk about it stressed the moves that the Federal Reserve is making in terms of dampening inflation expectations and statistics.

We see the same thing that they see. We just let the market inform us regarding what we should do about it.

When worry or enthusiasm goes to the polar extremes of pessimism and optimism, we find opportunity in terms of purchase or sell, overweight or underweight in individual securities, industries, and sectors.

Being an active investor requires us to do more than talk about it. We are paid by clients to be about it.

For the third quarter, we were rewarded for our stance that was aware of the market environment but not lock step in terms of positioning.

We have always found our own path to climb the wall of worry and we will always continue to do so.

Third Quarter Review

For the quarter, 6 out of 11 sectors outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value. Sector allocation drove the performance of the portfolio as stock selection was negative.

Performance for the Russell 1000 Value was very narrow with three sectors outperforming – Energy, Financials, and Technology. Demand for oil has overwhelmed oversupply concerns related to oil prices which have eclipsed $90 per barrel for both West Texas Intermediate and for Brent, which proved to be a key driver for the Energy sector. In terms of Financials and Technology, it appears that the market has resolved that the Federal Reserve may be closer to the

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end of the rate tightening cycle which may turn a headwind into a tailwind in terms of concerns over valuations being hampered by higher rates.

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

The three sectors with the highest contribution for the quarter were Energy, Health Care and Materials. In Energy, 6 out of 6 stocks outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value. As previously mentioned, the increase in crude prices has proven to be a catalyst for the sector overall and our holdings specifically. In Health Care, 3 out of 6 stocks outperformed as biotechnology and pharmaceuticals performed well as defensive characteristics came to the forefront as companies began to see efficacy in their product pipelines being more highly prized in the market. In Materials, 4 out of 5 stocks outperformed as the prospect of a cyclical extension and upturn could coincide with a less restrictive monetary and economic environment.

The sectors with the lowest level of contribution were Communication Services, Technology, and Financials. In Communication Services, 4 out of 5 stocks underperformed as many of the media related stocks outperformed with a correlation to Technology as the pressure on valuations appeared to subside while our holdings in traditional Telecom and Advertising were considered a bit more pedestrian in terms of prospects although the valuations are quite attractive. In Technology, similar to Communication Services, 3 out of 3 stocks underperformed as companies with more aggressive earnings prospects and valuations were favored as the pressure on valuations has become less of a concern for investors. In Financials, 5 out of 18 stocks underperformed as concerns in the Consumer Finance area regarding weakness among consumers as interest rates have risen caused investor sentiment to sour a bit on our holdings in this area.

The stocks with the greatest positive contribution were Phillips 66 (+27.13%), Apollo Global (+17.49%), ConocoPhillips (+16.90%), Amgen (+22.03%), and Oneok (+11.53%). These stocks represent holdings from the Energy, Financial and Health Care sectors. Higher oil prices help to drive the Energy stocks which still appear to be quite undervalued given the current level of oil prices. Similar to Technology and Communication Services, Apollo Global, as an alternative asset manager, saw the valuation rise as the prospects for investing and realization of current investments improved as the Federal Reserve rate hike cycle may be nearing an end. For Amgen, less concerns regarding the pipeline have given investors reason to be more optimistic on the stock, which was reflected in the quarterly performance.

The stocks with the greatest negative contribution were Discover Financial Services (-25.28%), Interpublic (-25.01%), Apple (-11.61%), Oracle (-10.75%), and Eastman Chemical (-7.45%). These stocks represent holdings from the Financial, Communication Services, Technology, and Materials sectors. Discover Financial Services has seen the perceived credit quality of it's customers decline due to rising delinquencies which have given investors reason to reconsider the overall Consumer Finance industry group. Interpublic, Apple and Oracle are quality companies that have not had the same type of more aggressive growth appeal of many of the companies in the sector which caused their stocks to decline. Eastman Chemical, with crude oil as a key feedstock, has had concerns regarding margins and profitability impact sentiment towards the stock.

During the quarter, stocks sold included KeyCorp, T. Rowe Price, S&P Global, Capital One, and Meta. The first four stocks were sold from the Financial sector with valuation being the key driver. Meta, a stock in the Communication Services sector, was sold on the basis of valuation. Two new securities were purchased – Valero and Marathon Petroleum, two stocks in the Energy sector.

Overall purchases and sells resulted in an increase in the Energy, Health Care, Consumer Staples and Materials sectors coupled with a decrease in the Financial, Communication Services and Industrial sectors. 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.

Fourth Quarter Outlook

After a rather lackluster third quarter in terms of stock market returns, investors are now looking towards a fourth quarter with a rather steep wall of worry.

Economically and socially, the economy has not slowed down enough for the Federal Reserve. Higher oil prices are not alleviating inflationary pressures and the very visible contentious employment environment where higher wage demands are being called for in a variety of areas.

Hope for a soft landing might fall victim to the Federal Reserve's focus on objective statistics which may create more economic pressures as interest rates continue to rise.

Could the Federal Reserve be close to an end? Good question. Immediate response. Who knows?

Should the Federal Reserve be close to an end? Great question. Immediate response. I think so.

As the world and the markets continue to reset and recalibrate from Covid-related issues, inflation has risen due to supply and demand being out of balance. The symptom has been higher inflation that we believe is more transitional than persistent. Transitional inflation is a response to immediate pipeline issues that will be resolved as supply normalizes to meet a more normal demand environment.

If so, then the Federal Reserve has already accomplished what needs to be done by creating a real rate of return above inflation.

We think this is more of the case and must be patient for the data to prove this to be the case.

In terms of the markets, concerns that the Federal Reserve may have more work to do is actually creating some interesting investment opportunities that we are eager to take advantage of in areas like Energy, Financials, Industrials and Technology.
In essence, we continue to think that a more aggressive pro-cyclical stance is likely to be more rewarded than one that is more defensive.

Valuations combined with fundamentals gives us confidence and our expectation is that our pursuit of *Value Creating Opportunities* in the fashion that we have done for over two decades will have our portfolio well-positioned for future outperformance.

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