KERUSSO CAPITAL MANAGEMENT
US LARGE CAP VALUE
ANNUAL/FOURTH QUARTER 2023 REVIEW

In 1973, James Brown released the album, "The Payback", which had the iconic song with the same title with the addition, "The (Big) Payback".

The song gave one the sense of being owed something.

The market operated in 2023 as if 2022 owed it something after a significant selloff in the prior year. The returns for the year proved to be a balm of relief that we were not going to have continuity of the negative returns experienced in 2022.

That is, if you experienced negative returns in 2022.

Kerusso had a positive return in 2022 and followed that up with positive returns in 2023, both years of outperformance of our benchmark, the Russell 1000 Value.

With inflation, interest rates, and market expectations taking center stage, there was "The (Big) Payback", although for many equity-related asset classes, they are still underwater from the beginning of 2022.

So, maybe, for some, 2022 was the year of "The (Partial Big) Payback".

Annual Review
For the year, 7 out of 11 sectors outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value. Stock selection contributed 70% to our outperformance with the balance being made up in stock selection.

Performance for the Russell 1000 Value was broad with six sectors outperforming – Communication Services, Technology, Industrials, Consumer Discretionary, Financials, and Real Estate. The risk-on, more cyclical outperformers represented a bit of the more speculative perspective that some investors adopted based on an end to rising interest rates and the possibility of rate cuts in the coming year.

For the year, the portfolio was primarily overweight Energy, Financials, Materials, and Consumer Discretionary. The portfolio was underweighted Health Care, Real Estate, Utilities, and Technology while being closer to equal weight in Consumer Staples, Communication Services, and Industrials.

For the year, the sectors with the highest level of contribution were Financials, Energy, and Materials. In Financials, 13 out of 19 stocks outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value, with leadership being broad-based as the market had to deal with the fallout from the collapse of Silicon Valley Bancshares. The lack of confidence in the banking sector was restored fairly quickly once the lack of a contagion was determined which helped most industry groups of Financials to perform well, especially those more risk oriented. In Energy, 5 out of 8 stocks outperformed with performance skewed towards the Refinery stocks coupled with select Exploration & Production companies. In Materials, 3 out of 5 stocks outperformed as cyclical stocks, Materials and Energy, performed well as the overall market fundamentals continued to improve along with dampening inflation expectations suggesting that demand should continue to rise.

The sectors with the lowest level of contribution were Communication Services, Real Estate, and Industrials. In Communication Services, 4 out of 5 stocks underperformed as our portfolio had a lack of exposure to the TMT (Technology-Media-Telecom) holdings that gained interest as the market gained a renewed interest in stocks that might benefit from the potential of lower interest rates. In Real Estate, our portfolio has no exposure and the outperformance of the sector resulted in a negative contribution. In Industrials, 7 out of 10 stocks underperformed as our exposure was less cyclical and lower beta than some of the areas that the market embraced on the prospect of lower rates.

The five top positive individual stock contributors were Apple (+49.00%), United Rentals (+63.61%), Blackstone (+82.72%), Apollo Global (+49.44%), and Celanese (+55.68%). These stocks represent holdings from the Technology, Industrial, Financial, and Material sectors. All of these stocks benefited from a change in mindset from the market in terms of expectations of the Federal Reserve coming to an end of the aggressive rate tightening cycle.

The stocks with the greatest negative contribution were META (+144.39%), Devon Energy (-21.87%), Pfizer (-41.22%), AT&T (-16.55%), and AES Corporation (-30.91%). These stocks represent holdings from the Communication Services, Energy, Health Care, and Utilities sectors. In terms of META, our stock position outperformed in terms of return but our underweight position caused it to be the largest negative contributor. Devon Energy underperformed with the concerns regarding demand for crude. Pfizer suffered with concerns over the portfolio. AT&T and AES lagged as defensive-oriented holdings lost appeal in a more risk-on environment.

Fourth Quarter Review

For the quarter, 8 out of 11 sectors outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value. Stock selection contributed 100% of the outperformance with sector allocation being negative.

Performance for the Russell 1000 Value was broad with six sectors outperforming – Real Estate, Financials, Technology, Industrials, Consumer Discretionary, and Communication Services. The market began to respond positively to the possibility of the Federal Reserve ending the current rate hike cycle in anticipation of rate cuts taking place in 2024.

For the quarter, our portfolio was predominantly overweight Energy, Financials, Materials, and Consumer Discretionary. The most significant underweights were Health Care, Real Estate, Utilities, and Communication Services while maintaining close to an equal weight position in Consumer Staples, Industrials, and Technology.

The three sectors with the highest contribution for the quarter were Financials, Energy and Industrials. In Financials, 11 out of 14 stocks outperformed the respective sector and/or the overall benchmark, the Russell 1000 Value. Leadership primarily came from Consumer Finance and Alternative Finance. In Energy, 7 out of 8 stocks outperformed although only one security had a positive return, Phillips 66. While the other securities had a negative return, only one of the remaining seven had a lower return than the sector as oil prices softened in the quarter. In Industrials, 5 out of 9 stocks outperformed as cyclicality was prized in anticipation of less pressure coming from the Federal Reserve coupled with continued solid fundamentals.

The sectors with the lowest level of contribution were Real Estate, Health Care, and Technology. In Real Estate, we had no exposure and the underweight position in the sector resulted in a negative contribution. In Health Care, 2 out of 6 stocks underperformed, Bristol-Myers Squibb and Pfizer, as these securities had the only negative returns among our holdings as concerns regarding product pipelines along with how near-term acquisitions will work out in the future. In Technology, 1 out of 4 stocks underperformed, Oracle, the only stock with a negative return, while the other three outperformed the respective sector and/or overall benchmark.

The stocks with the greatest positive contribution were United Rentals (29.42%), Discover Financial Services (+30.80%), Carlyle Group (+36.39%), Qualcomm (+31.04%), and Ameriprise (+15.67%). These stocks represent holdings from the Industrial, Financial, and Technology sectors. United Rentals and Qualcomm represent some of the cyclical parts of the economy with a tie into economic activity which should increase with a stronger environment and a moderation of interest rate increases. The other three stocks all come from the Financial sector that has rebounded with a more positive economic outlook that does not necessarily have to be inflationary.

The stocks with the greatest negative contribution were Pfizer (-12.01%), Valero (-7.50%), Devon Energy (-3.41%), Oneok (-2.49%), and EOG Resources (-2.80%). These stocks represent holdings from Health Care and Energy. Pfizer has pipeline concerns regarding the drug pipeline and the Energy holdings suffered from lackluster oil prices.

Each stock is still a portfolio holding as we continue to view them as *Value Creating Opportunities*.

Three new stocks were purchased during the quarter – Automatic Data Processing, Caterpillar, and Cummins – and five complete stocks were sold during the quarter – AT&T, Eastman Chemicals, Goldman Sachs, Oneok, and Yum Brands.

Coupled with purchases of existing holdings resulted in an increase in Industrials, Consumer Staples, Financials, Materials, and Utilities offset by decreases in Communication Services, Energy, and Consumer Discretionary. 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.

First Quarter Outlook

The reversal of returns for 2023 compared to 2022 was welcome for many investors as fundamentals continue to improve along with a taming of inflation expectations.
The former appears to be consistent with the world gradually coming out of the period of Covid with demand fairly intact and supply gradually becoming more cooperative.

The taming of inflation expectations as supply/demand conditions become a bit more normalized is where the market may be off-based in terms of the Federal Reserve's next moves.

The end to the current rate hiking cycle is a bit mistitled. What I mean is that the Federal Reserve aggressively cut interest rates in response to a brief period that was akin to a global depression. Had Covid not occurred, interest rates might likely be close to where they currently stand.

If that is the case, the expectation for a significant reversal of hikes giving way to cuts may be the wrong macro stance and set up investors for portfolio positioning that will prove untimely.

My expectation is that interest rates may stay around this level, a little higher if inflation resurfaces meaningfully, or a little lower if inflation dampens more than expected; but, I do believe that the Federal Reserve will make sure that the fixed income market is able to offer a level of real return on bonds.

As a result, the return to buying speculative securities at any price or paying speculative prices for sound companies on the notion that interest rates will head back to zero is imprudent.

Fortunately, at Kerusso, we do not try to predict. Instead, we simply invest in what we believe are the most attractively priced, fundamentally sound companies across our portfolio.

This approach has served our clients well historically and we believe that will likely be the case again in 2024 for, unlike the reference to James Brown's "The Payback", we do not truly believe that the market owes us anything other than an opportunity to discern where true value lies and to find ways to capture it.

Happy New Year and Be Blessed!

Randell A. Cain, Jr., CFA
Partner
Founder/CEO/CIO/Portfolio Manager
Kerusso Capital Management
January 4, 2023

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