LARGE CAP DIVIDEND GROWTH
3Q 2023 COMMENTARY

MARKET OVERVIEW

The S&P 500 gave back some of its robust 16.89% first half return in 3Q, with performance of -3.27%. Stocks remained bifurcated by market capitalization, but sector leadership rotated away from two of the first half's winners, Technology and Consumer Discretionary. Energy (12.26% return) and Communication Services (3.07%) were the strongest sectors in the face of higher interest rates and rising oil prices. These were the only positive returns among the 11 S&P 500 sectors although Financials (-1.13%) and Health Care (-2.67%) also outperformed the Index. The worst performers were the interest-rate sensitive Utilities (-9.25%) and Real Estate (-8.86%).

As noted, interest rates were up in the quarter with the July Fed Funds rate increasing to 5.25%-5.50%. Longer-term rates also rose, with the 10-Year U.S. Treasury starting the quarter at 3.81% and hitting 4.61% on 9/27 before closing the quarter at 4.59%. In total, the Fed Funds rate has increased by 5.25 percentage points in just over 16 months, the fastest pace of central bank increases in 40 years. The yield on the 10-Year U.S. Treasury has more than doubled from 2.20% over that same period. These increases have helped drive inflation down from 9.1% in June 2022 to a June 2023 low of 3.0% before it popped back up in July to 3.2% and again in August to 3.7%.

While inflation has come down, prices have remained elevated. Even though the unemployment rate is near its lows for this cycle (3.8% in August vs. 3.4% in April), higher price levels along with higher interest rates have started to affect the economy, with the lower-end consumer hit hardest so far. This, combined with the expectation that consumer spending power would be pressured by the resumption of student debt repayments, explains much of the lagging performance of consumer stocks in the quarter.

PORTFOLIO REVIEW

The Campbell Newman Large Cap Dividend Growth portfolio's -4.56% gross of fees return (-4.72% net of fees) underperformed the S&P 500's -3.27%. return. Stock selection accounted for all the relative lag.

Stock selection in the Industrials sector accounted for 80% (105 bps) of the portfolio's quarterly relative underperformance. This portfolio sector had a -13.91% return compared to the benchmark sector's -5.16%. Three of the four Industrials holdings underperformed in the period, with the worst performance coming from RTX (-26.03%) due to negative news in the quarter. While the team continues to believe in this stock's longer-term story, the position was reduced by 40% (See Bottom Contributors).

Stock selection in the Information Technology and Real Estate sectors cost 56 bps and 22 bps, respectively. The portfolio's Information Technology return was -7.15% vs. -5.64%, with Apple (AAPL), Texas Instruments (TXN) and TE Connectivity (TEL) each down over 11%. The most likely reason for these stocks' weakness is their cyclical inventory rightsizing, that is expected to last a few more quarters. The portfolio's Real Estate return was -15.78% vs. -8.86%, with the sector's two holdings, cell-tower companies American Tower (AMT) and Crown Castle (CCI), recording returns of -15.21% and -17.95%, respectively. While higher interest rates can be blamed for part of the lag for both stocks, in Crown Castle's case, earnings growth is likely to fall in 2024 and be flattish in 2025, due to higher rates but also exposure to Sprint-related churn. As a result, we believe future dividend increases are at risk, so the team decided to sell the stock on October 5.

The greatest contribution to relative performance came from the Index's best performing sector, Energy, which had a 12.26% return. The portfolio holds two Energy stocks, ConocoPhillips (COP, 16.69% return) and EOG Resources (EOG, 11.53%), which produced sector performance of 14.78%. Together, with a 30% sector overweight (5.73% vs. 4.39%), Energy added 28 bps relative.

TOP CONTRIBUTORS

Eli Lilly and Co. (LLY) had another strong quarter of performance driven by advancements in its pipeline. In the obesity market, Novo Nordisk's SELECT trial showed a 20% reduction in Major Adverse Cardiovascular Events (MACEs), which has strong implications for LLY's GLP-1 obesity drug. LLY expects the drug to be approved by year-end, with some analysts projecting around $50 billion in GLP-1 sales by 2050. Separately, the company reported encouraging data in Alzheimer's with LLY expecting an FDA decision by year-end, and some analysts projecting it as a $20 billion plus opportunity.

ConocoPhillips (COP) exhibited strong operational execution in 2Q with record production driven by activity acceleration and strong well performance, particularly in the Permian basin. Also, COP stock benefited from the 30% increase in the price of oil during the quarter, rising from a low of $69 to $91 at the end of September.

EOG Resources, Inc. (EOG) delivered another quarter of exceptional operating performance with production volumes, capital expenditures and cash operating costs all better than expected. The first half results reflect consistent operating execution across its multi-basin portfolio to lower costs and generate free cash flow. Also, EOG stock benefited from the 30% increase in the price of oil.

BOTTOM CONTRIBUTORS

RTX Corp. (RTX) disclosed the discovery of microscopic contaminants in a powdered metal used in high-pressure turbine discs that are part of the Geared Turbo Fan engine's core. These contaminants could lead to cracks in the engine necessitating an accelerated inspection schedule. RTX anticipates a $3 billion free cash flow impact over the 2023 to 2025 timeframe, with 80% of this going toward customer concessions. While the team continues to believe in this stock's longer-term story, the position was reduced by 40% because it's likely the problem will cost more and take longer to correct than expected.

Apple, Inc. (AAPL) reported an inline fiscal 3Q 2023 on strong iPhone sales and Services, which more than offset the weakness in Mac and iPad sales. The weak stock performance was due to the fiscal 4Q guidance of negative year-over-year revenue growth which is below investor expectations given positive data points in the supply chain. Management attributed the fiscal 4Q weakness to Mac/iPad and FX headwinds. We continue to view AAPL favorably given its high quality of earnings and strong balance sheet.

Stryker Corp. (SYK) underperformed following strong outperformance in the first half of the year despite reporting a solid 2Q earnings result with revenue up over 11% driven by a continued recovery in surgeries. Management believes elevated orthopedic procedural demand will continue well into 2024 with the current backlog about twice the size as normal. Additionally, growth will benefit from what management is calling a product supercycle with multiple important product releases through 2024. We remain positive on the outlook.

PORTFOLIO POSITIONING

Portfolio turnover was 3.5% in the quarter. KLA Corp. (KLAC) and Eli Lilly & Co. (LLY) were both trimmed because their strong performance triggered two of our hard-wired risk control disciplines while, as discussed, the position size of RTX was reduced on the back of some negative news. Additionally, the team initiated new positions in Zoetis (ZTS), Hershey Foods (HSY) and Genuine Parts Co. (GPC). It's noteworthy that Hershey is the first Consumer Staples holding in the portfolio since 2Q 2017.

The team expects to see additional fallout over time from tightening monetary conditions, making stock selection with a focus on earnings growth and predictability, which promotes true dividend growth, all the more critical. The portfolio's positioning reflects where the team has identified the best risk/return opportunities within its disciplined stock selection process. At the end of the quarter, Information Technology had the highest exposure at 33.5%, followed by Health Care (15.3%), Financials (14.0%), Industrials (9.3%), Consumer Discretionary (7.5%) and Energy (6.2%). Taken together, Communication Services, Real Estate, Materials and Consumer Staples accounted for 9.1% of the portfolio while there were no Utilities holdings.

TOP AND BOTTOM ABSOLUTE CONTRIBUTORS

3Q 2023 TOP CONTRIBUTORS	WEIGHT	RETURN (NET)	IMPACT (NET)
Eli Lilly & Co.	3.41%	14.76%	53 bps
ConocoPhillips	3.63	16.69	50
EOG Resources, Inc.	2.10	11.53	20
Comcast Corp.	2.88	7.46	18
UnitedHealth Group	2.96	5.31	14

3Q 2023 BOTTOM CONTRIBUTORS	WEIGHT	RETURN (NET)	IMPACT (NET)
RTX Corp.	3.59%	-26.03%	-100 bps
Apple, Inc.	5.86	-11.62	-72
Stryker Corp.	3.79	-10.19	-41
Analog Devices, Inc.	3.93	-9.71	-39
TE Connectivity Ltd.	3.17	-11.47	-38

PERFORMANCE

	3Q 2023	YTD 2023	1 YEAR	5 YEARS	10 YEARS
Representative Account (Gross)	-4.56%	7.70%	21.64%	10.63%	12.37%
Representative Account (Net)	-4.72	7.17	20.88	9.92	11.66
S&P 500 Index	-3.27	13.07	21.62	9.92	11.91

Returns greater than 1 year are annualized.

IMPORTANT DISCLOSURES:

Past performance is not indicative of future results. All investments involve risk, including possible loss of principal. There is no guarantee investment objectives will be met. Gross returns are presented before deducting management fees (and custodian fees) and include the reinvestment of all income. Net returns are presented after deducting management fees (and custodian fees) and include the reinvestment of all income. Performance returns are calculated using a time-weighted formula with appropriate adjustments for cash flows, and include all dividends and interest, accrued income, and realized and unrealized gains or losses. Indexes are unmanaged and do not incur fees or expenses. It is not possible to invest directly in an index. Portfolio sector weights reflect a representative account and are subject to change without notice. Sector returns are presented net of management fees. It should not be assumed that an investment in the sectors listed were, or will be, profitable. Portfolio holdings reflect a representative account and are subject to change. Portfolio holdings returns are presented net of management fees. Other accounts within the strategy may have different holdings. Portfolio holdings should not be considered a recommendation to buy, hold or sell securities. Current and future portfolio holdings are subject to risk. Past performance does not guarantee future results. The future performance of any specific investment should not be assumed to be profitable or equal to past results. The performance of the holdings discussed above may have been the result of unique market circumstances that are no longer relevant. The holdings identified above do not represent all of the securities purchased, sold or recommended. Securities mentioned should not be construed as recommendation for purchase or sale. Portfolio transactions should not be considered a recommendation to buy, hold or sell securities.

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