4Q 2023 Commentary

Quality Dividend Fund

Portfolio managers, Tom Mulroy and Mike Scherer, provide their current insight on the equity market and the management of the Quality Dividend Fund.

What a difference one year makes. At this time in 2023, we were pleased to have dodged many of the issues encountered by the S&P 500, NASDAQ Composite, and the Dow Jones Industrial Average. All three of those widely-followed indices experienced significant 2022 declines of 18.11%, 32.54%, and 6.86% respectively. However, what performed relatively well in 2022, did not carry over into 2023. In fact, many of the best performing individual stocks and sectors in 2022 were the worst performers in 2023, and vice versa.

In 2023, the cap-weighted S&P 500 Index outperformed the S&P 500 Equal Weight Index by a significant 12%, representing the second largest divergence historically between the two with data going back to 1971—only 1998 generated a wider gap at 16%. Conversely, in 2022, S&P 500 Equal Weight outperformed its cap-weighted counterpart by nearly 7%—the most since 2010.[1] Such large performance disparities typically occur within volatile markets.

Technology companies, particularly those propelled by positive leverage to the demand for Artificial Intelligence, were the disproportionate winners in 2023. This outsized influence bolstered a significant divergence in equity market performance between the large cap technology stocks and most other equity asset classes. According to Bank of America, *"last year was the narrowest breadth year in history, going back to 1987, meaning that if you look at the percentage of stocks in the S&P 500 that actually beat the S&P 500 index, only 27% of stocks outperformed."*[2] We believe it is unlikely that such narrow breadth is sustainable.

Most market prognosticators got 2023 wrong. The predictions of doom and gloom to start the year, and the consequences these insurmountable risks would have on the markets, never materialized. At the beginning of 2023, the probability of a pending recession seemed elevated in an environment facing stubbornly high inflation, slowing consumer spending, increasing unemployment, ongoing Federal Reserve (Fed) interest rate hikes (the fastest in 40 years), and geopolitical tensions. We find it wise to maintain a healthy bit of skepticism when it comes to Wall Street strategists' macro predictions. Instead, we focus on building a portfolio that seeks to provide consistent income generation and the potential for capital appreciation to help investors mitigate significant market corrections.

In 2023, the biggest single macro factor weighing on the portfolio was the rise in interest rates. Many investors seized the opportunity to move money into higher yielding short duration government bonds or money market funds, which competed directly with high quality dividend-paying stocks.

1) Bilello, Charlie, "2023: The Year in Charts," www.bilello.blog, January 7, 2024.
2) Kwon, Ohsung. "Active Managers Had Another Rough Year. Why 2024 Could Be Better." By Lauren Foster. *Barron's*, January 6, 2024.

TICKERS

CLASS A: QDVAX
CLASS C: QDVCX
CLASS I: QDVIX

MANAGEMENT TEAM

THOMAS P. MULROY
Executive Vice President
Senior Portfolio Manager

MICHAEL S. SCHERER
Senior Portfolio Manager

ABOUT EQUITYCOMPASS

EquityCompass Investment Management, LLC ("EquityCompass") is a wholly owned subsidiary and affiliated SEC registered investment adviser of Stifel Financial Corp. EquityCompass offers a broad range of portfolio strategies based on its research-driven, rules-based investment process, which merges traditional investment theory with quantitative techniques. SMA portfolios based on EquityCompass model portfolios are available primarily through affiliated broker dealer, Stifel, Nicolaus & Company, Incorporated. As of December 31, 2023, EquityCompass provided portfolio strategies with respect to assets over $4.7 billion.*

As we enter 2024 and focus on the potential for a slowing economy and lower interest rates, we can make the argument that many of our portfolio companies have already experienced an earnings recession. Therefore, earnings should begin to improve in the coming quarters. We believe the combination of potential earnings improvement and lower interest rates at some point during the year could represent catalysts for dividend stocks to begin to move higher.

We feel the Fund's sector weightings are appropriate and provide an opportunity for modest earnings growth, sustainable dividend income, and growth in income. Financials constitute the largest sector weighting at 18.4%, followed by Health Care (17.7%), Consumer Staples (14.2%), Information Technology (11.3%), Energy (10.8%), Industrials (10.6%), Materials (6.9%), Consumer Discretionary (6.4%), and Real Estate (3.7%).

Through year end, 21 of the Fund's 28 holdings raised their dividend an average of 3.3%. In our opinion, it is reasonable to expect dividend increases throughout 2024. We believe our Fund companies are committed to maintaining a consistent and growing dividend regardless of the current economic environment.

2024 Outlook

The focus remains on the Fed's ability to slow the economy and tame inflation without pushing it into a recession. While the economy seems to be on better footing that many would have forecasted given the surge in interest rates, a soft landing for the economy is still not a certainty. In addition, the amount and timing of potential interest rate cuts by the Fed may be somewhat optimistic in light of stubbornly high inflation. These remain key risks. However, investors remain positive heading into the new year, as a Bank of America survey recently noted that two-thirds expect a soft landing for the economy.

From our perspective, it appears the Fed may be done raising interest rates after holding them steady for three consecutive meetings. However, the market has interpreted the Fed's pause to mean substantial interest rate cuts could occur in 2024, with six 25 basis point rate cuts built into the current fed funds futures. This seems aggressive, especially with inflation still running higher than the Fed's 2% target. We believe a more likely scenario is that the economy continues to show some resilience and inflation slowly makes its way to the Fed's target. If such an environment plays out, the Fed can take its time cutting rates. While the pace of interest rate cuts may be somewhat slower than the market currently expects, it is the direction of interest rates that may matter the most to the performance of income-generating stocks within the Quality Dividend Fund.

The 2023 performance gains in the S&P 500 and the NASDAQ Composite will be difficult to replicate in 2024. That does not mean that there are not opportunities for investors to profit. The broadening out of the market rally we saw late in the fourth quarter bodes well for the laggards that did not participate in the technology-led rally that occurred for much of 2023. If this trend continues, then dividend stocks, which were on the sidelines for most of 2023, may represent a good balance of income and capital appreciation in 2024. ■

For the Fund's standardized performance, please click here.

The **S&P 500®** is regarded as the best single gauge of large-cap U.S. equities. According to our Annual Survey of Assets, an estimated USD 15.6 trillion is indexed or benchmarked to the index, with indexed assets comprising approximately USD 7.1 trillion of this total (as of Dec. 31, 2021). The cap weighted index includes 500 leading companies and covers approximately 80% of available market capitalization.

The **S&P 500 Equal Weight Index** is based on the S&P 500. All index constituents are members of the S&P 500 and follow the eligibility criteria for that index. The S&P EWI is maintained in accordance with the index methodology of the S&P 500, which measures 500 leading companies in leading U.S. industries. The S&P EWI measures the performance of the same 500 companies, in equal weights. As such, sector exposures in the S&P EWI will differ.

The **NASDAQ Composite Index**, comprised mostly of technology and growth companies, is a market value-weighted index of all common stocks listed on NASDAQ.

The **Dow Jones Industrial Average (DJIA)** is an unmanaged, price-weighted index that consists of 30 blue chip U.S. stocks selected for their history of successful growth and interest among investors. The price-weighted arithmetic average is calculated with the divisor adjusted to reflect stock splits and occasional stock switches in the index.

A **basis point** is a standard measure for interest rates and other percentages in finance. One basis point equals 1/100th of 1%, or 0.01% (and .0001 in decimal form). Basis points (bps) are used to show the change in the value or rate of a financial instrument, such as 1% change equals a change of 100 basis points and 0.01% change equals one basis point.

The volatility of the indices identified in this report may be materially different from the volatility of the Fund presented by EquityCompass. Indices are unmanaged, do not reflect fees and expenses, and are not available for direct investment.

This material must be preceded or accompanied by a prospectus by clicking here.

Any projections, targets, or estimates in this report are forward looking statements and are based on EquityCompass research, analysis, and assumptions made by the Adviser.

EquityCompass Investment Management, LLC is a wholly owned subsidiary and affiliated SEC registered investment adviser of Stifel Financial Corp. Registration does not imply a certain level of skill or training.

This commentary often expresses opinions about the direction of market, investment sector, and other trends. The opinions should not be considered predictions of future results. The information contained in this report is based on sources believed to be reliable, but is not guaranteed and not necessarily complete. All investments involve risk, including loss of principal, and there is no guarantee that investment objectives will be met. It is important to review your investment objectives, risk tolerance, and liquidity needs before choosing an investment style or manager. Equity investments are subject generally to market, market sector, market liquidity, issuer, and investment style risks, among other factors to varying degrees. Fixed Income investments are subject to market, market liquidity, issuer, investment style, interest rate, credit quality, and call risks, among other factors to varying degrees.

The specific securities identified and described herein do not represent all of the securities purchased, sold, or recommended to advisory clients, and the reader should not assume that investments in the securities identified and discussed were or will be profitable. A complete list of all recommendations made by the firm is available upon request. Quality Dividend Fund is distributed by Foreside Funds Distributors LLC, not an affiliate of EquityCompass.