Scharf Quality Value Strategy

MONTHLY COMMENTARY

APRIL 2024

- The Scharf Quality Value Strategy returned -4.71% (net of fees) for the month-ending period.
- After solid year-to-date returns, the Strategy and equity markets broadly declined in April over concerns of persistent inflation and higher for longer interest rates.
- The momentum factor, cyclicality and tech stocks, all leaders in recent months, stumbled.
- The Strategy remains positioned in companies we believe offer compelling earnings resilience, yet priced at discounts to broader equity markets and intrinsic value.

MARKET REVIEW

Markets broadly declined in April as U.S. economic growth and inflationary metrics backed up interest rates, with the 2-year U.S. Treasury increasing 45 bps to 5.04%. Consensus anticipates just one discrete Fed cut in 2024 after expecting six at the beginning of the year.

There was less dispersion across returns in April, but the risk-on trade carrying stocks higher since the Fall stumbled. The momentum factor and cyclical stocks, strongly leading through Q1, slightly trailed the broader indices. The Russell 1000 Value Index declined -4.27%, but the Russell 1000 Value Dynamic (cyclicals) declined -4.78%. All sector returns were negative.

Given a 21x 2024 P/E for the S&P 500 and imminent rate reductions off the table, investors are betting earnings growth will accelerate from an anemic 0.9% growth rate in 2023. Midway through Q1 earnings season, blended YoY EPS growth is just 3.5%.

PORTFOLIO REVIEW

For the month, the Strategy returned -4.71% (net of fees), trailing both the Russell 1000 Value Index and the S&P 500 Index, which returned -4.27% and -4.08%, respectively.

At the sector level, the leaders were stock selection in Health Care, Real Estate, and Consumer Discretionary. The leading laggards were stock selection in Communication Services, Information Technology, and over allocation to underperforming Communication Services. Overall, the Strategy added 46 bps of value via stock selection, but sector allocation resulted in 79 bps of drag vs. the Index.

At the stock level, the top attribution contributors were McKesson, Novartis, not owning lagging Intel, Heineken, and not owning lagging Home Depot. The largest detractors were CVS Health, Comcast, Match, Oracle, and Microsoft.

We completed the sale of Valvoline. Originally purchased in 2020, the stock delivered strong returns for the Strategy. The investment thesis – that the company was mistakenly cast primarily as a cyclical materials business instead of a fast-growing and cash flow rich, quick car maintenance service franchise – played out successfully. Management sold the legacy Valvoline oil business to Aramco in 2023 and used the proceeds to reduce the share count by 26%. The stock has rerated since and no longer offered a compelling Favorability Ratio, or upside vs. downside return potential. At purchase, the Favorability Ratio was greater than 3-to-1 and traded just a little above its median low historical P/E ratio.

OUTLOOK

Risks: In addition to optimistic 2024 margins and earnings, valuations remain especially rich in Information Technology as the sector is now approximately 30% of the S&P 500 and trades at a 28x P/E, more than 50% above its 20-year average. The sector grew revenues just 2% in 2023. AI development is not increasing aggregate IT spend in the short term, so actual profitable consumer and corporate adoption would better come sooner than later to justify sector valuations. Accenture reported 0% Q4 YoY revenue growth.

All data as of April 30, 2024.

Past performance is not indicative of future results. The securities identified and described do not represent all of the securities purchased, sold, or recommended for client accounts. The reader should not assume that an investment in the securities identified was or will be profitable.

Opportunities: P/E dispersion, on par with levels last seen during the 2000 tech bubble, presents a compelling investment opportunity for value stocks and non-mega cap names. Meanwhile, quality value (low EPS volatility) should mitigate the risk of traditional value stocks' (e.g., Energy, Financials, Materials) high operating leverage should the global economy slow.

Annualiized Rates of Return (%) as of March 31, 2024	YTD	1-Year	3-Years	5-Years	10-Years	Inception
Scharf Quality Value (Gross)	**6.5%**	**22.5%**	**10.2%**	**13.0%**	**10.9%**	**13.9%**
Scharf Quality Value (Net)	**6.3%**	**21.5%**	**9.3%**	**12.0%**	**9.9%**	**12.6%**
Russell 1000 Value Index	9.0%	20.3%	8.1%	10.3%	9.0%	10.3%
S&P 500 Index	10.6%	29.9%	11.5%	15.1%	13.0%	10.9%

Scharf Quality Value (Net) represents a 1% Scharf management fee. Scharf Quality Value (Max Net) is the Scharf Quality Value (Gross) reduced by the highest wrap fee of 3% applied annually. Additional information regarding relationships and services can also be found in the Firm's Form ADV Part 2A.

As of July 1, 2023, the Scharf Sustainable Value Composite was renamed to the Scharf Quality Value Composite.