

## Equity Income Strategy (EI)

### Quarterly Commentary

#### Portfolio Update

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In the face of rising short-term interest rates, dividend-paying stocks have recently underperformed non-dividend payers. At record high yield curve inversion, we expect a reversal of this underperformance as the yield curve normalizes.

We did not add new positions this quarter but eliminated two. At risk from the inverted yield curve and commercial real estate problems, we sold **Prudential Financial (PRU)** to fund additions to higher conviction positions. The second position we sold was **Advance Auto Parts (AAP)**, which we characterize as a portfolio management mistake. We have extensive experience making investments in the auto parts industry and were initially attracted to AAP after management initiated two large dividend increases as a part of their turnaround plan. However, we failed to appreciate just how difficult an operating environment the company was facing (supply chain issues, rising fixed costs, anemic same-store sales). After management dramatically cut the dividend this quarter, we concluded the company could not complete its turnaround within our investment horizon. We sold AAP and redeployed the proceeds into other holdings.

#### Risk Focus: Trade, Taiwan, China, and Global Security

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Trade is essential for the global economy. When conducted in a fair manner, it facilitates win-win outcomes characterized by prosperity and low inflation. No product illustrates this dynamic better than semiconductors. For decades, Western developers have seamlessly partnered with Asian manufacturers to produce more powerful and cheaper chips. Efficiency gains seem endless. Semiconductors are therefore among the world's most essential products. Unfortunately, Taiwan single-handedly produces 90 percent of the most advanced semiconductors. Any problems in this country will have dramatic consequences that will reverberate across the globe.

The rising tensions between China and Taiwan are a red flag in this context. China believes they have sovereignty over Taiwan, while the Taiwanese staunchly desire independence. Relatedly, U.S. and Chinese relations have soured over a host of issues. Trade restrictions imposed by both governments are reducing growth and increasing costs for everyone. The potential for a cold war between the world's two largest economies is a significant long-term risk that financial markets have not discounted.

While we are bottom-up, fundamental investors, we believe understanding how global macro forces might impact our portfolio is a key element of risk management. As such, we have reviewed every holding's supply and demand exposure to China and are reducing this risk when geographic concentration is unfavorable.

#### Market Commentary and Outlook

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Stocks experienced a strong rally in the second quarter, building on momentum from the first quarter. Signs of reduced inflation and excitement over artificial intelligence (AI) fueled these returns. However, market leadership was narrow—just seven large technology companies accounted for nearly three-quarters of the S&P 500's year-to-date return. Known collectively as the "Magnificent Seven," Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla and Meta were up an average 90 percent in the first half of 2023. Most other stocks underperformed, and 40 percent of the stocks in the Index delivered negative returns. The environment has created headwinds for active managers who do not believe it is prudent to subject clients to this level of concentration.

While the list of issues for investors to worry about is long, we are optimistic about the U.S. economy and equity markets. We base our optimistic view on our forecast for continued gains in productivity. Businesses are investing in innovation and finding efficiencies to deliver sustainable, profitable growth. Consumers should benefit from more valuable products and services. Areas like AI, cloud computing, and 5G communications provide the platforms that power this potential. We are attempting to position portfolios responsibly in companies leading this innovation while keeping an eye on future risks.

<sup>1</sup> The S&P 500® Index measures the value of stocks of the 500 largest corporations by market capitalization listed on the New York Stock Exchange or Nasdaq Composite. Past performance is not indicative of future results.

## Best and Worst Performers in the Quarter

### Top Contributors

Broadcom  
 Digital Realty Trust  
 JPMorgan Chase  
 Pool Corporation  
 Vail Resorts

### Top Detractors

Advanced Auto Parts  
 AbbVie  
 Crown Castle  
 SLM Corp Preferred Series B  
 Amgen

Reflects the top five holdings that contributed to and detracted from composite performance listed in descending order. Specific securities identified do not represent all the securities purchased, sold, or recommended for the strategy. A contribution analysis list of all holdings and calculation methodology information are available upon request. Do not assume any securities identified were or will be profitable. Past performance is not indicative of future results.

## Why Consider Torray Investment Partners as Your Equity Income Solution?

### A Singularly Focused Investment Firm

#### OUR CULTURE



Independent, Stable and Client Centric

Broad-based active equity ownership bound by a partnership mentality drive tight alignment with our client's long-term interests.

#### OUR APPROACH



Risk-Managed, Concentrated Investing

For more than 50 years, we've built active portfolios based on our research-driven conviction in the relatively few businesses able to create economic value for shareholders.

#### OUR STRUCTURE



Institutional-Quality Boutique

Unburdened by bureaucracy, we are more creative and agile in efforts to deliver exceptional client service and consistent long-term risk-adjusted performance.

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