Torray
INVESTMENT PARTNERS

Q1
2024

Equity Income (EI)

Quarterly Review and Commentary

The EI strategy returned 7.7% (net of fees) for the first quarter modestly underperforming its relative indices. These results follow a solid year of compounding in 2023. When we think we can increase yield, improve our prospective long-term returns, and lower the portfolio's risk profile, we will make those decisions without regard to their impact on short-term results.

There were similar themes to market leadership that fueled returns, including investor optimism that the Federal Reserve has inflationary pressures under control and exuberance for companies that have the potential to benefit from Artificial Intelligence (AI). AI promises a similar (and likely broader, steeper, and longer-lived) impact as other ground-breaking technological innovations such as PCs, the internet, and smartphones. We discuss our risk-managed approach to investing in AI below.

Based on contributions to return, our stock selection in Information Technology had the largest positive impact on relative performance. All four of our Industrial holdings combined to be the largest detractors.

A Risk-Managed Approach to AI Exposure

AI presents a wide variety of direct and indirect investment opportunities. However, not all companies with exposure to AI will be meaningful beneficiaries over our investment horizon, while others may emerge and do better than expected. Regardless, we apply the same disciplined, risk-managed approach to investing in AI that we do with all our investments. We do not compromise the investment criteria we use to identify TIP-Quality Businesses (1. Business Quality, 2. Risk/Reward Profile, and 3. Management Team) simply because of the excitement around AI.

We focus on business quality, seeking evidence that future profits will be competitively protected and grow sustainably. We analyze each company’s products to ensure they create lasting value for their customers—such as improving productivity. Given the threat of disintermediation from technological change, this is essential when investing in AI. We compare company fundamentals to market expectations to pay a reasonable price for the stock and use our correlation analysis to increase portfolio diversification. Finally, the management team must have a record of value-creating capital allocation.

Encouragingly, we are finding many ways to responsibly invest in AI when viewed through our risk-managed lens. Although we have chosen not to invest in NVDA, many portfolio companies are using their semiconductors to build AI platforms and enhance existing services, creating durable recurring revenues and cost savings. We also own semiconductor manufacturing and design businesses that play crucial roles in creating the chips and intellectual property that make AI work. Finally, we have invested in several of NVDA’s competitors because innovation and price pressures inevitably spark change, which will likely create attractive opportunities for them.

Portfolio Activity

PURCHASES

Morgan Stanley (MS) is a global investment bank whose history can be traced back over 87 years. More recently, management has shifted its focus to expanding its wealth and asset management businesses. The firm has more than doubled its margins in these businesses since 2012. As a result, it is increasing the resiliency of its business model. As more of the firm’s revenue is generated from these steadier business lines, we expect the company to continue returning capital to shareholders by increasing its dividend payout and share repurchases over time.

Royalty Pharma (RPRX) is a leading acquirer of market-leading pharmaceutical royalties and has amassed an impressive track record building a diversified and durable royalty revenue streams. We see the company as one of the fastest-growing diversified biopharma stories operating in a highly attractive and fragmented niche within the healthcare market. We acquired shares at an attractive discount to our conservative estimate of the future value of existing royalty streams.

United Parcel Service (UPS) is the world’s largest parcel delivery and logistics company. Following a contentious negotiation with its labor union that resulted in painful wage hikes behind them and CEO Carol Tome’s renewed focus on cost control through her “better, not bigger” framework, we believe UPS represents significant value. Particularly considering their exposure to AI in logistics. In 2022, UPS raised its dividend for the 15th consecutive year by almost 50%. The stock currently yields an attractive 4.3%, which we believe is sustainable as package volumes, driven by the secular shift to ecommerce, continue to rise while the company benefits from significant efficiency gains as their AI initiatives in logistics, begin to take hold.

SALES

Gilead Sciences (GILD) is a biopharmaceutical company that discovers, develops, and delivers innovations in virology and oncology

Portfolio Activity cont...

medicines to prevent and treat life-threatening diseases. The company's core portfolio focuses on HIV and hepatitis B and C. Management has reduced share repurchases and dividend growth to provide flexibility for recent acquisitions into new therapeutic areas such as oncology. We are skeptical when a company shifts from a reliable dividend strategy to chase bygone growth glory. Our research indicates that the company's recent acquisitions have struggled to deliver value. As a result, we sold the stock in favor of Royalty Pharma, which offers a more transparent risk and reward profile.

LyondellBasell Industries (LYB) is one of the largest producers of petrochemicals and chemical derivatives that form downstream chemicals and plastics used in a range of packaging, health, and transportation solutions. Oil and gas prices and global manufacturing demand are vital to the company's margin profile. Short-term swings, like the COVID-induced global supply chain constraints, can have a material impact on profitability. While we suspect these conditions will continue to normalize, the threat of rising regulation and litigation will likely persist. We took the opportunity at the beginning of a new tax year to redeploy the capital to improve the portfolio's risk and reward profile.

Paychex (PAYX) is a leading provider of outsourced human resources and insurance solutions to small and medium businesses (SMBs) nationwide. We see competitive threats in payroll and human capital management software from nimble and innovative start-ups and established accounting software providers expanding to become full-service providers, rising. The company's exposure to SMBs also magnifies its reliance on labor and economic conditions. We sold the stock during the quarter to enhance the portfolio's overall yield by adding UPS.

Best and Worst Performers in the Quarter

Top Five	Return	Contribution
Broadcom	19.2	1.0
Phillips 66	23.6	1.0
Qualcomm	17.7	1.0
SLM Corp Pfd	18.1	0.8
AbbVie	18.6	0.7

Bottom Five	Return	Contribution
American Tower	-8.5	-0.5
United Parcel Service	-5.1	-0.2
Cisco Systems	-0.4	0.0
Blackstone	1.1	0.0
Paychex	0.8	0.0

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?

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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Disclosures