Scharf Quality Value Strategy

MONTHLY COMMENTARY

DECEMBER 2023

- The Scharf Quality Value Strategy returned 4.42% (net of fees) for the month-ending period.
- The Strategy outperformed its Russell 1000 Value Index benchmark in 2023, 15.88% (net of fees) vs. 11.42%.
- Magnificent 7 tech-related growth stocks roared in 2023, delivering a median return of 81%. The P/E spread between growth and value stocks returned to historical highs after the Russell 1000 Growth Index returned 42.68% vs. 11.42% for Russell 1000 Value Index.
- We believe the Strategy's structural bias towards high earnings resilience at relative low valuations provides relative opportunity in a slowing economy, but a market not priced for one.

MARKET REVIEW

It was the revenge of the average stock—the "Boring 493"—in December. The S&P 500 Equal Weight Index outperformed the median Magnificent 7 stock, 6.86% vs. 4.00%, delivering more than half of its 13.46% calendar-year return in a single month.

Cyclicals especially ran hard in December over optimism for a soft landing, slowing inflation, and expectations for an acceleration in interest rate cuts in 2024. Value outperformed growth by small measure, but cyclicality was the real winner. The Russell 1000 Value-Dynamic Index outperformed the Russell 1000 Value-Defensive Index, 7.89% vs. 3.12%.

The Russell 2000 Index returned 12.22% during the month. Whether December represents a fundamental market shift—value, cyclicals, and small caps all outperformed large-cap growth and the Mag 7—remains to be seen as we head into the new year. The Mag 7 continues to lag badly in the first week of 2024 trading. Relative valuations and earnings growth estimates support return conversion.

PORTFOLIO REVIEW

For the month, the Strategy returned 4.42% (net of fees), while the Russell 1000 Value Index and the S&P 500 Index returned 5.52% and 4.53%, respectively.

At the sector level, 2023 attribution contribution was led by stock selection in Health Care, Consumer Staples, and Industrials. The leading laggards were over allocation to underperforming Health Care, and stock selection in Real Estate and Consumer Discretionary.

At the stock level, the top attribution contributors were Booking Holdings, Microsoft, McKesson, Oracle, and MillerKnoll. The largest detractors were not owning outperforming Broadcom, Advance Auto Parts, CVS Health Care, Centene, and not owning outperforming Intel.

We added a small position in Match (MTCH) in December. After recent negative market reaction to near-term guidance, MTCH appears excessively cheap for a market-leading, profitable, and capital-light business in the growing online dating industry. MTCH trades at approximately 14.0x 2024E GAAP EPS estimates, its historically widest discount vis-à-vis the S&P 500. MTCH is well-positioned to capitalize on growth in consumer adoption of, and willingness to pay for, online dating. We expect the company to generate double-digit earnings growth over the next 3-5 years. We view near-term sentiment issues as a favorable risk-adjusted opportunity if longer-term earnings power remains intact.

Using historical long-term median high and low P/E ratios, our current portfolio has a Favorability Ratio of approximately 4-to-1 vs. the Russell 1000 Value's approximately 1-to-1 Favorability Ratio and the S&P 500's approximately 1-to-4 Favorability Ratio.

All data as of December 31, 2023.

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.

OUTLOOK

Risks: Investors are likely too bullish about near-term earnings given slowing ISM figures, near-term guidance, lowered EPS estimates, and all-time high 2024 margin assumptions vs. continued wage pressures, geopolitical risk and demographics, and recent evidence of consumer demand elasticity. Meanwhile, valuations remain especially rich in Information Technology as the sector now represents nearly 30% of the S&P 500 and trades at a 24x P/E, 33% above its 20-year average.

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

Annualized Returns (Net of Fees)
as of December 31, 2023

	1-Year	5-Year	10-Year
Scharf Quality Value	**16.02%**	**12.84%**	**9.44%**
Russell 1000 Value	11.42%	10.88%	8.38%
S&P 500	26.30%	15.68%	12.02%

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