RS MID CAP VALUE STRATEGY QUARTERLY COMMENTARY

RS Investments
A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of September 30, 2024

Market Commentary

At first blush it may appear that the song remained the same for the U.S. equity market. The third quarter saw a continuation of this year's rally, with the broad market, as measured by the S&P 500® Index, delivering returns of almost 6%, bringing the total return to more than 22% through the first three quarters of the year. Where the tune has changed, however, is in market breadth. That was good news for our value-oriented strategies. It was encouraging to see a broadening of market leadership take hold in the third quarter with upside participation beyond the usual artificial intelligence (AI), technology and communication services stocks. In fact, we've seen a downright rotation away from large-cap tech stocks into more value-oriented names and, importantly, into the seemingly long-ignored small-caps.

What was the catalyst for this broadening? Perhaps it was driven by the start of the Federal Reserve's easing cycle. Although the Fed had been preaching its "higher for longer" mantra for quite some time, the turning point came during the summer with a slew of (relatively) tame inflation data, along with a July jobs report that showed slackening of tight labor markets. Although the start of a new Federal Reserve easing cycle became a foregone conclusion, the timing and extent of the first rate cut was uncertain. But at the September FOMC meeting, the Fed finally slashed the federal funds rate by 50 basis points, more than many pundits were expecting. This was the first rate cut since 2020, and the easing of monetary conditions may have provided a catalyst for more interest-rate-sensitive small-caps and other areas of the market during the quarter.

Of course, it wasn't a straight shot by any means, and the third quarter offered its share of bumps and bruises. In fact, August was an especially volatile month as investors were caught off guard by what looked like rapidly slowing economic growth, as well as an unwinding of the Japanese yen-carry trade thanks to an unanticipated rate hike by the Japanese central bank. But despite the turmoil in August, stocks were little changed over the course of the month and resumed their march higher in September, even in the face of elevated geopolitical tensions and an escalation of the war in the Middle East.

As value-oriented investors, we were delighted to see the rotation out of large-cap tech and into value stocks, which were market leaders during the third quarter. In terms of the overall numbers for our particular area of focus, the Russell 3000® Value Index increased 9.5% during the third quarter, bringing the year-to-date return to 16.2%. In terms of market capitalizations, small-cap value stocks represented by the Russell 2000® Value Index increased 10.2% for the quarter. The Russell Midcap® Value Index increased by 10.1%, while large-cap stocks represented by the Russell 1000® Value Index rose 9.4% during the same period.

Looking ahead, it's important to acknowledge the potential headwinds. There have been signs of slowing economic growth, which must be balanced against the prospect of a more accommodative monetary policy. A broader regional conflict in the Middle East is another serious concern. And, of course, we are heading into the home stretch of a combative and uncertain U.S. presidential election, which might usher in new policies that could have a material impact on various sectors and industries. Yet despite those ever-present risks, there should be ample opportunities for value-oriented investors, in our opinion.

We continue to believe that actively managed, value-oriented strategies are well positioned going forward, especially if investors renew their focus on individual company fundamentals and balance sheets. Our team will continue to search for companies with a combination of improving ROIC (return on invested capital) and stock prices trading at what we perceive as a deep discount to intrinsic value. We believe that allocating to these types of businesses is a means to generate attractive risk-adjusted returns over longer time periods, and this continues to be a primary focus for us as we look toward the remainder of 2024 and beyond.

Performance Review

For the three months ended September 30, 2024, the RS Mid Cap Value strategy underperformed its benchmark Russell Midcap® Value Index (the "Index") and returned 8.9% net versus a return of 10.1% for the Index.

In the third quarter, strong performance from stock selection in Consumer Staples and Financials aided relative performance, while stock selection in Information Technology and Industrials detracted.

Investment Strategy

The RS Value Team seeks to invest in good companies, led by strong management teams, that are attractively valued. Our decision to invest in any company starts with business analysis and an understanding of the company's unit-level economics. Our work on unit-level economics helps us determine the quality and key drivers of the business. We are ROIC-focused investors and seek to invest in companies that we believe have the potential to create shareholder value due to an improvement in the returns of the existing assets or through attractive reinvestment opportunities. We are long-term investors who use our investment time horizon as a competitive advantage and are attracted to out-of-favor and/or misunderstood companies in the market.

The next step in our process is to assess the management team. Our evaluation of a company's management team is critical to our investment decision. We regularly meet with management to gauge how they think about their business: Are they focused on (and compensated for) growing earnings at any cost, or do they understand ROIC and how value is created? Additionally, we perform detailed historical analyses of management's capital decisions—looking at acquisitions, asset sales, and measures of capital stewardship. This analysis provides us with the conviction to invest with strong management teams that we expect will be able to navigate through short-term market volatility and appear to be poised to deliver long-term shareholder value.

The final step in our analysis is valuation. To the RS Value Team, value investing is buying a business at a discount to what we believe it is actually worth. We determine what a company is worth by assessing a company's current share price versus its expected cash flow streams or long-term net asset value based upon the management team's plan for value creation. ROIC is the lens through which we analyze that value creation. Our research has shown that, over time, stock price performance has a strong correlation to improving ROIC as opposed to traditional valuation measurements like price to earnings (P/E). We seek to invest in companies that we believe can create shareholder value due to an improvement in the returns of the company's existing assets or through attractive reinvestment opportunities. We pay close attention to a company's financial strength, scrutinizing financial statements, and we run various financial models to understand our downside risk. This quantitative analysis gives us confidence in our investment thesis and helps us determine at what stock price we are comfortable investing.

Select Position Review

Below, we review two businesses in an effort to use tangible examples to highlight our investment process.

Keurig Dr Pepper Inc. (KDP) was formed in 2018 following the merger of privately owned Keurig Green Mountain and publicly traded Dr Pepper Snapple Group. KDP manufactures and distributes nonalcoholic beverages, including soft drinks, coffee, juices, teas, mixers, water, and other ready-to-drink beverages. It is one of North America's largest beverage companies, with more than 125 owned, licensed, and partner brands. It owns the #1 single-serve coffee system in the U.S. (Keurig) and has grown Dr. Pepper to become the second largest soft drink brand in the U.S., having overtaken Pepsi by the end of 2023.

While KDP has displayed steady growth and market share gains in its larger "cold beverage" segment (two-thirds of profits) for many years, the company's at-home coffee segment (one-third of profits) slowed in 2023 as post-Covid return-to-office trends caused revenue growth to slow. Weak top-line growth on the coffee side combined with inflationary pressures to result in more muted overall earnings growth for the company in 2023. Our view was that the trends experienced in the coffee segment during 2023 would eventually stabilize, and with the cold beverage segment continuing to gain share, KDP could return to its historical earning growth pattern of 8%–10% annually. With KDP shares trading at 14x EPS (a 30% discount to beverage peers), we increased our position in KDP during the first half of 2024 to become our largest name in Consumer Staples. Signs of stabilization on the coffee side started to appear on the second quarter update from KDP, which allowed shares to outperform its Consumer Staples peers this quarter. As management continues to execute and the market gains confidence in a return to historical annual earnings growth, we believe there is more upside to come in the shares of KDP given its relative discount to peers and earnings growth prospects. We therefore continue to hold KDP shares as one of our top positions in the portfolio.

PVH Corp. (PVH) is a global apparel company operating under two primary banners: Calvin Klein and Tommy Hilfiger. In 2021, Stefan Larsson took the reins as CEO of PVH. Larsson is a proven leader in the apparel space, with successful track records at H&M, Old Navy, and Ralph Lauren. Thus far at PVH, he has streamlined the business by selling non-core brands and has shown early success in his initiatives to elevate the product and improve brand perception with more culturally relevant marketing. More importantly, in the next two to three years we believe there is a significant margin expansion opportunity that will be unlocked as he integrates the supply chains and systems of the business that have historically been operated separately by each brand. In addition, PVH will be bringing in-house the U.S. women's businesses of both Calvin and Tommy, which are currently being licensed to another company. Under our base case, we see earnings per share increasing by 50% to 60% over our investment time horizon.

Despite trading at an undemanding 10%+ free cash flow yield, PVH shares underperformed in the third quarter as the company cautioned against a slightly slower consumer demand environment in the second half of 2024 in a couple of international geographies, including China. While the global consumer macro situation at present is not particularly strong, we believe there are enough self-help opportunities at PVH to drive company-specific improvements in the business over the next few years that will ultimately lead to improved share price performance. We continue to hold PVH and will look to add to our position over the coming quarters as we get closer to the time of expected top-line inflection.

Outlook

The rate of inflation has subsided, and the Federal Reserve lowered interest rates for the first time in more than four years. Debate is now focused around how much the Fed may be willing to ease in the coming months, given that inflation is still above its target. Easing is not without risks. The U.S. and the rest of the world continue to manage the impacts of excessively elevated prices and higher interest rates while contending with geopolitical upheaval. The potential for a policy error remains high, particularly as we transition from a pandemic to a normalized economy. At this juncture, we continue to lean toward a slowdown in economic activity through the remainder of 2024.

U.S. employment remains strong, and we believe the pieces are in place for that to continue. Heavy fiscal stimulus from passed U.S. legislation for defense, infrastructure, semiconductors, and energy investments is only now beginning to be awarded. The spending should not peak until later in the decade. We believe relatively high energy costs in Europe, and Germany in particular, make manufacturing here relatively more attractive. In our view, political risk in China makes that country less attractive to do business in. We expect housing to continue to be challenged by high mortgage rates and affordability concerns, although a shortage of housing after more than a decade of underinvestment should help home prices. Consumer balance sheets remain generally healthy for the majority of Americans, and consumer credit quality remains strong at the moment.

Following years of low interest rates helping to drive ever-higher growth stock valuations, we feel value investing is ripe for a period of outperformance. We continue to find opportunities to invest in quality businesses with solid balance sheets and cash flows, where the return on invested capital (ROIC) is improving, and whose share prices have detached from our assessment of the fundamentals.

We thank you, as always, for your support.

Sincerely,

RS Value Team

Top Contributors (Representative Account)
As of September 30, 2024

Holding	% Contribution to Return
Vistra Corp.	0.76
Progressive Corporation	0.58
PNC Financial Services Group, Inc.	0.44
SS&C Technologies Holdings, Inc.	0.41
Keurig Dr Pepper Inc.	0.40

Top Detractors (Representative Account)
As of September 30, 2024

Holding	% Contribution to Return
Alphabet Inc. Class A	-0.34
Applied Materials, Inc.	-0.29
McKesson Corporation	-0.25
Merck & Co., Inc.	-0.22
Marathon Oil Corporation	-0.15

Composite Performance
Average Annual Returns as of September 30, 2024

RS Mid Cap Value Composite	Third Quarter 2024	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception*
Gross of fees	9.08%	16.32%	25.80%	10.77%	11.00%	9.78%	9.73%
Net of fees	8.92%	15.79%	25.04%	10.10%	10.33%	9.03%	8.24%
Russell Midcap® Value Index	10.08%	15.08%	29.01%	7.39%	10.33%	8.93%	10.70%

Past performance does not guarantee future results. Returns for periods greater than one year are annualized. Returns are expressed in U.S. dollars and reflect the reinvestment of dividends and other earnings. Composite and benchmark returns are presented net of non-reclaimable withholding taxes, if any. Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Net-of-fees returns reflect gross performance less investment management fees. Net-of-fees returns are calculated by deducting 1/12 of the highest tier of the standard fee schedule in effect for the period noted (the model fee). The composite model fee for each period is either the highest tier of the current fee schedule or a higher value, whichever is required to ensure the model composite net-of-fee return is lower than or equal to the composite net-of-fee return calculated using actual fees. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The firm's fees are available on request and may be found on Part 2A of its Form ADV. *06/30/1993.

All investments carry a certain degree of risk, including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class.

Index returns are provided to represent the investment environment during the periods shown. Index performance does not reflect management fees, transaction costs or expenses that would be incurred with an investment. One cannot invest directly in an index.

Contributors and Detractors Source: FactSet. The top contributors and detractors are presented to illustrate examples of the portfolio's investments and may not be representative of the portfolio's current or future investments.

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The Russell Midcap® Value Index is a market-capitalization-weighted index that measures the performance of Russell Midcap® Index companies with relatively lower price-to-book ratios and lower forecasted growth.

The RS Mid Cap Value Strategy primarily invests in a diversified portfolio of mid-cap companies.

Information relating to portfolio holdings is based on the representative account in the composite and may vary for other accounts in the strategy due to asset size, client guidelines, and other factors. The representative account is believed to most closely reflect the current portfolio management style.

Advisory services offered by Victory Capital Management Inc., an SEC-registered investment adviser, 15935 La Cantera Parkway, San Antonio, TX 78256.

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