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PRIVATE WEALTH

Neuberger Berman – The Greene Group

All Cap Intrinsic Value "ACIV"

Market Context

Equity markets came under pressure during the third quarter as interest rates continued to move higher. Since early April, the yield on the 10-year treasury has increased approximately 120 bps to 4.50%. Higher interest rates create competition for investors' dollars and are a significant headwind for equities. For the third quarter, the S&P 500 Index ("S&P 500") lost 3.27%, bringing the year-to-date returns to 13.07%. A select group of large cap technology stocks (Nvidia, Meta, Amazon, Microsoft, Apple, Alphabet and Tesla), most recently dubbed "The Magnificent Seven", continue to dominate returns for the S&P 500. A broader measure of the market, the equal weighted S&P 500 dropped 4.90% for the quarter and is up just 1.79% year-to-date. Our portfolio returns outperformed the equal weighted index for the quarter but trailed the index for the year-to-date period.

Stocks reacted negatively to the Federal Reserve's (the "Fed") policy announcement that they would likely keep rates higher for longer. While the rate hike cycle appears to be ending, yields continued to move higher and are at levels not seen since before the global financial crisis in 2008. Additional negative news during the quarter included sustained economic weakness across Europe and China and a significant increase in the price of oil. On the flip side, consumer spending remains strong, buoyed by solid job growth and prolonged low unemployment rates. Corporate earnings have remained robust, evidence that at least for the time being strength in the consumer sector has held a recession at bay.

The resiliency of the economy has been surprising given the inverted yield curve and extremely tight fiscal and monetary policies. However, the full impact of the Fed's actions remains to be seen as it typically takes over a year for Fed tightening to impact the economy. However, the Fed has successfully lowered inflation, albeit not enough to reach their stated target rate of 2%. While it is conceivable that the Fed may orchestrate a soft landing (a slowdown in growth without a recession), much of the economic data is backward looking, and we are particularly mindful of the mantra "don't fight the Fed", reminding us to be cautious, particularly as both monetary and fiscal policy remain restrictive.

While the recent spike in interest rates is good for savers who can get a higher return on their fixed income investments, it pressures both consumers and businesses as their borrowing costs increase. Mortgage rates have reached pre-2000 levels. Rates are also higher for home equity, car, and credit card loans and banks have tightened their lending standards. Higher rates have negatively impacted technology stocks which had significant gains earlier in the year as future profits are worth less given higher discount rates. The termination of various COVID era stimulus policies – particularly the deferment of student loan payments, which analysts estimate can remove up to $100 billion from consumers' wallets, and a more than 20% increase in oil prices during the quarter – is further pressuring consumers. For the Fed to reach its 2% inflation target, consumer spending must weaken.

As we await third quarter earnings and management comments on their outlook for the rest of this year and next, we note that given the continued strength in the economy, earnings estimates for the current quarter have drifted higher. This year the S&P 500 is expected to earn $221 compared to $219 last year, and earnings are projected to grow 11% to $246 next year according to Bloomberg. Should this be achieved, the S&P 500 would be trading at 19.4x this year's and 17.4x next year's estimates, above the historical market multiple of 16x. It appears to us that considering the lag in the effect of monetary policy on the economy, estimates for next year are too high and could be adjusted down. In light of this and in the current high interest rate environment, valuations seem to be elevated, which may create headwinds for equities going forward.

Portfolio Review

As discussed, we have been surprised with the resiliency of the economy during the year and have taken a conservative stance. We have positioned the portfolio for a significant deceleration in economic activity by increasing our cash position (investing in higher yielding money market funds and short-term treasury bills) and holdings in undervalued utilities, healthcare, and consumer staples companies, which are more defensive areas of the economy. Given the myopic view of investors on growth, our holdings in these sectors performed poorly despite attractive valuations. Our utilities stocks reacted negatively to higher interest rates, but we believe the losses are excessive given their attractive valuations, above average and growing dividend yields, and earnings growth rate of between 5% and 8%. Some of our healthcare stocks performed poorly despite positive fundamentals, with investors mostly focused on companies that are linked to obesity therapies. Finally, our consumer staples companies reacted negatively to a slowdown in the ability to raise product prices. We believe our holdings in these sectors will be strong contributors going forward given their attractive valuations.

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While we have been patient in adding new holdings to the portfolio during the last few quarters, during the third quarter we initiated two new positions – PayPal Holdings and Hain Celestial Group. PayPal provides a technology platform that enables digital and mobile payments for consumers and merchants. The company has experienced increasing competition and recently hired a new CEO to help stabilize and turn around the business. Hain Celestial, a natural and organic food company, is transforming from an overly complex rollup to a more focused operating company. Sales and margins remain overly depressed following pandemic driven cost inflation and supply chain disruptions. Under the new management team, we believe the company is on the cusp of expanding product distribution, recovering margins, and generating substantial cash flow that should lead to balance sheet deleveraging and increased shareholder value. We added to our holdings in Dollar Tree and Bristol-Meyers Squibb. We trimmed our positions in ConocoPhillips and AbbVie, and for taxable accounts, we took tax losses in Huntington Bancshares and Truist Financial.

Outlook

We have had a cautious outlook since the beginning of the year, and although the economy has been resilient to date, our concerns persist. We believe the Fed's rate increases will likely lead to a recession or economic slowdown, which has not yet been priced into equity markets, particularly given the current elevated valuation levels. While we believe the general market is highly valued, we believe our portfolio holdings are well positioned given their significant discount to our estimates of intrinsic value (as evidenced by the proposed offer by Sycamore Partners to take Chico's private at a 65% premium to its trading value prior to the offer).

As we approach the end of the year, it is worthwhile to look at tax planning strategies. To this end, please let us know of any tax considerations that you would like to discuss.

Thank you for your continued support of the Greene Group. We look forward to updating you at the end of 2023.

This material is intended as a broad overview of the portfolio managers' current style, philosophy and process. This material is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. Neuberger Berman is not providing this material in a fiduciary capacity and has a financial interest in the sale of its products and services. Investment decisions and the appropriateness of this material should be made based on an investor's individual objectives and circumstances and in consultation with his or her advisors. This material is presented solely for informational purposes and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. No recommendation or advice is being given as to whether any investment or strategy is suitable for a particular investor. Information is obtained from sources deemed reliable, but there is no representation or warranty as to its accuracy, completeness or reliability. All information is current as of the date of this material and is subject to change without notice. Any views or opinions expressed may not reflect those of the firm as a whole. Third-party economic, market or security estimates or forecasts discussed herein may or may not be realized and no opinion or representation is being given regarding such estimates or forecasts. Certain products and services may not be available in all jurisdictions or to all client types. Unless otherwise indicated, returns shown reflect reinvestment of dividends and distributions. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results**.
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Intrinsic value reflects the team's analysis and estimates. There is no guarantee that any intrinsic values will be realized; security prices may decrease regardless of intrinsic values.

Representative portfolio information (characteristics, holdings, weightings, etc.) is based upon the composite or a representative/model account. Representative accounts are selected based on such factors as size, length of time under management and amount of restrictions. Client accounts are individually managed and may vary significantly from composite performance and representative portfolio information. Specific securities identified and described do not represent all of the securities purchased, sold or recommended for advisory clients. It should not be assumed that any investments in securities, companies, sectors or markets identified and described were or will be profitable. Securities mentioned may not be held in all client accounts as investment objectives, tax considerations and other factors may vary from account to account.

S&P 500 Index: Consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value. The "500" is one of the most widely used benchmarks of U.S. equity performance. As of September 16, 2005, S&P switched to a float-adjusted format, which weights only those shares that are available to investors, not all of a company's outstanding shares. The value of the index now reflects the value available in the public markets. Investing in foreign securities involves greater risks than investing in securities of US issuers, including currency fluctuations, interest rates, potential political instability, restrictions on foreign investors, less regulation and less market liquidity.

For more information on COVID-19, please refer to the Center for Disease Control and Prevention at cdc.gov.

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