

Select Dividend Investment Team

Adam Steffanus | Portfolio Manager

Michael Valentinas | Portfolio Manager

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Quarterly Investor Letter

Inflection NOT Stagflation

The chattering class reflexively answers “What Is Stagflation?” to the Jeopardy answer that is: “An economic scenario of weakening labor market but strengthening inflation”. Now, employment and inflation are moving in opposite directions signaling an economy in transition. Recently, payrolls have softened while inflation is slowly warming up. Inflation is above the Fed’s 2% target but remains mild. Interestingly, goods inflation was not a major contributor to the recent CPI uptick thus silencing the “tariffs cause inflation crowd”. Long time readers, know our view that tariffs are not inflationary but an anti-growth tax hike (specifically on consumer wallets and corporate profits). Most importantly, the labor market always leads inflation or said another way, inflation always follows employment, so it should remain relatively benign if the labor market remains sluggish.

Seller’s Market -> Buyer’s Market

The labor market has shifted from a seller’s market to a buyer’s market as there are now more unemployed workers than job openings. The press has popularized the “low fire, low hire” environment driven largely by tariff uncertainty. Corporates have been hesitant to pass through tariff costs with some pass-through estimates as low as 20%. Most companies do not have the pricing power that pundits expect as they operate in very competitive environments. Numerous companies have noted \$1B tariff hits to earnings (Nike, General Motors). Corporates are pulling some of the few levers that they can: cutting discretionary advertising expenses and instituting hiring freezes.

A Process

Economies are dynamic, constantly churning in a choppy sea of competing macro forces. The current process is a slow deceleration of underlying growth. The sustained ‘low fire, low hire’ suppresses consumer spending (especially at the low-end) until a reflexive process takes hold – that of a recession. The Fed is desperate to avoid a recession and now appears exclusively focused on one of their dual mandates (the labor market) while implicitly acknowledging that a 2% inflation target is arbitrary (and made up by the Bank of New Zealand interestingly).

Recession?

A recession remains elusive for now and is not our base case. We expect the Fed to cut 75-100 bps over the next 12 months, which should be enough to keep the economy on track. The current macroeconomic environment is void of previous recessionary tinderboxes: an unsustainable macro imbalance that kicked off past recessions. Past examples include the overinvestment during the late 1990s telecom boom, the property bubbles in the early 2000s, and levered balance sheets during the Great Financial Crisis. Today’s economy features tighter labor markets, moderate inflation, improving productivity growth, robust corporate /

household balance sheets and soon-to-be neutral monetary policy. This is in stark contrast to the previous decade's low GDP growth, weak wage growth, general deleveraging and experimental monetary policy (QE, ZIRP, negative interest rates).

AI Bubble?

Market pundits are quick to toss around words like 'bubble' when they've missed the boat and underperformed. The latest narrative is that the AI boom is an unsustainable AI bubble. The most common arguments for an AI bubble include: (1) extreme infrastructure investment (2) foundational models have diminishing returns (3) not profitable and (4) missing productivity gains.

We are the least persuaded by the AI infrastructure investment argument. Since early 2023, AI investment has increased 23% vs. 6% GDP growth (cumulatively). In contrast, telecom investment compounded at a 20% rate for five consecutive years during the Dotcom bubble (~250% cumulative). AI investment is around 0.5% of total GDP today (vs. 1.2% for telecom in 1999).

We are not informed enough technologically to critique foundational models. We do know that AI bots have massively exceeded expectations in the short term and will continue to evolve. The market is giving the technology the benefit of the doubt and so will we.

We also know that Silicon Valley is masterful at monetizing demand. Remember when Instagram was purchased for an eye-popping \$1B when it only had 30M users? Instagram has 2B monthly average users today. In three short years, ChatGPT has exploded with over 2.5B daily queries and 700M users. By comparison, Google processes ~10B queries each day and 3B monthly average users.

Lastly, we are bullish on AI to transform businesses. Generative AI is the general-purpose technology of our era. General-purpose technologies (ex: steam engine, electricity, computers) have three characteristics: 1) can improve over time 2) are widely used throughout the economy and 3) are platforms for new innovations. General purpose technologies are responsible for most of the productivity and economic growth. AI is now beyond the experimentation phase and entering the implementation phase. AI cannot do entire jobs and functions but will replace specific tasks. Coding, programming, customer service, general management, supply chain management, and communication are ripe for disruption. Job losses will occur in certain functions and new, entirely unforeseen jobs will be created along with massive consumer surplus from enhanced productivity. Productivity is the magic pixie dust behind great economies. It can produce economic booms while also keeping a lid on inflation, lifting the fortunes of workers and business owners alike.

What to Follow in the Fall

Trump's tariffs will be the central showdown in the last quarter of the year. The Supreme Court will hear the IEEPA case and will likely rule against the administration, creating even more tariff chaos in the short-term. The good news is that the blanket 10-15% universal tariffs will likely be unconstitutional. The bad news is that Trump is a self-declared 'tariff man' and will continue to flex his executive privilege. This means more narrow but higher sectoral tariffs under the guise of national defense. The market will adjust to this new tariff regime as it always does. We do expect a lower effective tariff rate in the high single digits from the mid-teens

currently. There is an outside chance that the current Administration simply takes the Supreme Court loss as it focuses on the 2026 Mid-Term elections.

The big fiscal pivot is happening outside the U.S.

In a watershed moment, Germany is abandoning a decade of fiscal austerity intends to increase deficit spending to 5-6% of GDP on defense and infrastructure. The broader European Union is also aiming to boost economic growth primarily driven by significant public spending on infrastructure, digitalization, and defense spending. The tailwinds of fiscal coordination and rate cuts will likely result in positive economic surprises in Europe heading into 2026. China fired their fiscal bazooka (2% of GDP), which will add to economic momentum heading into 2026.

Global growth prospects are looking up as the immediate threat of extreme U.S. tariffs has receded, calming fears of a recession and stabilizing GDP predictions. This is a slow-moving multi-year process which is underappreciated by investors and a key reason why we remain very bullish on Global equities.

Performance Update

Trailing Returns (%) as of 9/30/2025							
Strategy	YTD	1 Year	3 Years	5 Years	10 Years	Since Inception	Inception Date
Global Select Dividend (gross)	24.55	22.37	25.11	17.00	11.38	10.50	12/31/10
Global Select Dividend (net)	23.89	21.50	24.23	16.15	10.57	9.69	12/31/10
<i>iShares MSCI ACWI ETF</i>	18.56	17.56	23.24	13.55	12.05	9.81	
U.S. Select Dividend (gross)	18.16	16.94	24.16	18.78	14.37	13.90	12/31/10
U.S. Select Dividend (net)	17.53	16.11	23.28	17.93	13.55	13.07	12/31/10
<i>iShares Russell 1000 ETF</i>	14.34	17.54	24.40	15.82	14.88	13.78	
Small Cap Core (gross)	12.09	9.73	16.77	14.71	11.06	11.57	9/30/12
Small Cap Core (net)	11.49	8.95	15.94	13.90	10.26	10.76	9/30/12
<i>iShares Russell 2000 ETF</i>	10.37	10.73	15.11	11.42	9.71	10.02	

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