

Select Dividend Investment Team
Adam Steffanus | Portfolio Manager
Michael Valentinas | Portfolio Manager
October 1, 2026
Quarterly Investor Letter

P(Doom) On Your Bingo Card?

We've sat in these seats for almost 20 years and are always amazed by the financial discourse bouncing from one topic to another. In the last 12 months, we've ping ponged between AI bubbles, stagflation, panic wars and now the end of humanity from rogue AI. Our lesson learned is that if there is no wall of worry to climb, then there are no returns to be earned.

Enhanced Compute Not Animal Instincts

One of the oldest tricks in the book is personification: give an inanimate object human qualities, and it becomes more relatable, vivid, and emotionally resonant. Silicon Valley has done exactly this with the phrase “Artificial Intelligence,” using it to raise hundreds of billions of dollars and sell a dream to consumers, enterprises, and politicians. Some labs lean into dystopian framing and foretell millions of lost jobs or the end of humanity. This conveniently doubles as a case for the regulatory moats that would lock in today's leaders and box out cheaper, open-source competitors.

We anthropomorphize AI to our detriment. AI lacks any urge to survive, reproduce, or rule. It isn't a biological creature. It is an ethereal algorithm, completely devoid of human desire or ego. Ultimately, it is just a compute tool that executes our instructions, even if it occasionally finds unexpected paths to get there.

What if instead, the Valley chose the phrase “Enhanced Compute”? We would argue that this phrase is far less animalist and monetizable. And then we could have a more rational investment discussion about the uses, adoption, economics, liability, regulation and growth path of Enhanced Compute.

The “AI Trade” Remains Intact

We continue to believe the “AI bubble” debate in public markets is often framed incorrectly. The AI rally is being driven by fundamental earnings growth rather than speculative multiple expansion. “Picks and shovels” providers (chipmakers like NVIDIA selling into hyperscalers and LLMs) are capturing the bulk of those profits. Valuations for the leading AI beneficiaries have actually compressed over the past six months even as prices rose, because earnings grew faster. Investors are discriminating on earnings potential rather than chasing hype indiscriminately.

The more important questions are economic. Can frontier model developers earn adequate returns as cheaper open-weight alternatives drive real price competition? And will compute pricing hold once today's supply shortages ease?

The IPO Trap Hiding Inside Your Index

If there's a place where AI-era froth is landing directly in unsuspecting portfolios, it's the index itself. SpaceX has already IPO'd; OpenAI and Anthropic are likely to follow in the next two quarters. Index providers have quietly rewritten their own rules to fast-track these companies into major benchmarks, abandoning the traditional 6–12 month waiting period historically used to let free-float and price discovery normalize. Many of these companies list with single-digit free-float percentages, meaning passive investors are buying in at valuations set by a sliver of tradeable shares. Historically, IPOs are a bad bet in aggregate — of every five, fewer than one doubled over their first three years, one gained but failed to double, and three lost money¹. Passive investors no longer get to opt out of that lottery as the index is doing the buying for them. We view this as a quiet, structural headwind for passive strategies going forward, and another reason we favor concentrated, high-conviction active management over indexing in this environment.

Don't Get Stuck in the Value Trap

AI's leadership is real, and the consequence for traditional dividend strategies is that they're structurally underweight growth and risk being left behind entirely. The S&P 500's dividend yield has fallen to roughly 1.1%², increasingly forcing income investors into “broken” businesses — shrinking, low-growth franchises with high yields but little organic growth. That's not where we want to be.

International markets offer dividend yields two to three times higher³, and among our global holdings we're finding companies growing dividends 15–20% annually. As a simple illustration, an investment yielding 3% whose dividend grows 15–20% a year could realize an effective 6–7.5% yield on cost in five years. This is precisely why we've deliberately built our Select Dividend strategies to maintain a style balance rather than skew hard into value or chase pure yield, as many traditional dividend ETFs do. We want to participate in dividend growth while still delivering income, not choose between them.

Higher Oil Prices Are Here to Stay

Back in Q1, with the Iran war just weeks old, we put roughly 2:1 odds on a diplomatic resolution over a sustained closure of the Strait of Hormuz, doubting Iran controlled the Strait or that global powers would tolerate prolonged disruption. Iran's responses stayed proportional and core energy infrastructure remained untouched.

¹ Jay R. Ritter, "Distribution of 3-year and 5-year Buy-and-Hold Returns on IPOs, 1975–2021," Table 16e in IPO Statistics (University of Florida, Warrington College of Business, updated March 23, 2026), <https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf>. Returns measured from first-day closing price; includes dividends.

² Source: Bloomberg. S&P 500 Index trailing 12-month dividend yield as of September 30, 2026.

³ Source: Bloomberg. MSCI AC World Index ex USA Index (2.3%) and MSCI EAFE Index (2.5%) trailing 12-month dividend yields vs. S&P 500 Index, as of September 30, 2026.

More importantly, we argued the war mattered less to markets than the prevailing narrative implied. Prognosticators overestimated how much oil China would keep buying and underestimated how fast Gulf producers could reroute supply.

Going forward, we expect prices to stay elevated. The U.S. blockade is acting much like a medieval siege, taking months or years to achieve its objectives — after all, no one expected the Russia-Ukraine war to still have no end in sight four years later.

Bond Vigilantes Return?

The bond market has repriced sharply, going from expecting five Fed cuts a year ago to now expecting two hikes in the next three Fed meetings⁴. The chattering class assumes the bond market is flagging fiscal risks or a new bout of inflation. Yet the term premium remains modest by historical standards and offers little compensation for a new regime where 2% inflation now looks like a floor, not a ceiling⁵.

In our view, the market repricing reflects a reassessment of Fed monetary policy, as the rate rise is concentrated in the two-year Treasury. The AI freight train isn't helping. Capex-driven demand and supply bottlenecks are proving inflationary before any efficiency gains show up. Layer on a reaccelerating labor market (the key swing factor) and the risk tilts toward more tightening into 2027.

In this environment, we think equities remain the better inflation hedge. Moderate, controlled inflation has historically supported the nominal earnings growth that drives stock performance. Bonds don't offer the same ballast.

Gridlock Is a Feature, Not a Bug

The midterms will dominate headlines this fall, but we'd file them under “minor issue” relative to the AI buildout. History rhymes here: the party out of power typically regains ground in Congress, and equity returns in years three and four of a presidential cycle have historically outpaced years one and two—largely because gridlock constrains extreme policy swings from either party. We'd expect a similar dynamic this cycle. The real fight for investors to watch over the next two election cycles will be over AI regulation and AI liability law.

Objectivity, Conviction, Humility

Our biggest lesson learned over nearly 20 years of managing money is to always fade the headlines and stick to our investment process. We remained focused on our disciplined process – objectivity and breadth, cash flows over earnings, accretive over destructive capital deployment – to build high conviction portfolios.

⁴ Source: CME Group FedWatch Tool, based on 30-Day Fed Funds futures pricing as of September 30, 2026 and September 30, 2025.

⁵ Source: Federal Reserve Bank of New York, Adrian, Crump, and Moench (ACM) 10-year Treasury term premium estimate (ACMTP10), as of September 30, 2026.

Disclosures

Past performance does not guarantee future results. Investing in securities involves risk, including the possibility of the loss of principal.

Please see Advisory Research's Form ADV Part 2A, which is available upon request, for more information.

Certain information contained herein constitutes forward looking statements, projections and statements of opinion (including statements of financial market trends). Such information can typically be identified by the use of terminology such as "may", "will", "should", "expect", "anticipate", "project", "estimate", "intend", "continue" or "believe" or comparable terminology. All projections, opinions and forward-looking statements are based on information available to Advisory Research as of the date of this presentation, and Advisory Research's current views and opinions, all of which are subject to change without notice. Due to various risks and uncertainties, actual events or results may differ materially from those reflected or contemplated in forward looking statements. Additionally, information and views presented herein may be drawn from third-party or public sources which are believed, but not guaranteed, to be reliable and which have not been verified for accuracy or completeness.

Advisory Research is providing this material for informational purposes only. The information provided is not intended to recommend any company or investment described herein and is not an offer or sale of any security or investment product or investment advice. Before making any investment decision, you should seek expert, professional advice and obtain information regarding the legal, fiscal, regulatory, and foreign currency requirements for any investment according to the laws of your home country or place of residence.

The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. The MSCI AC World Index ex USA Index is a free-float weighted equity index. It was developed with a base value of 100 as of December 31, 1987. The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

Advisory Research's strategies are actively managed and not intended to replicate the performance of any cited index: the performance and volatility of Advisory Research's investment strategies may differ materially from the performance and volatility of a cited index, and their holdings will differ significantly from the securities that comprise the index. You cannot invest directly in an index, which does not take into account trading commissions and costs.

Advisory Research is an investment adviser in Chicago, IL. Advisory Research is registered with the Securities and Exchange Commission (SEC). Registration of an investment adviser does not imply any specific level of skill or training and does not constitute an endorsement of the firm by the Commission. Advisory Research only transacts business in states in which it is properly registered or is excluded or exempted from registration. A copy of Advisory Research's current written disclosure brochure filed with the SEC which discusses among other things, Advisory Research's business practices, services and fees, is available through the SEC's website at: www.adviserinfo.sec.gov.