TRIBUTARY
CAPITAL MANAGEMENT

EQUITY INCOME
MARKET COMMENTARY

PORTFOLIO MANAGERS: DONALD RADTKE & NICHOLAS NEVOLE **FIRST QUARTER 2024**

	Quarter	Year to Date	1 Year	3 Years	5 Years	Since Inception*
Tributary Capital Management (Gross of Fees)	6.0%	6.0%	13.3%	7.7%	9.7%	10.1%
Tributary Capital Management (Net of Fees)	5.8%	5.8%	12.6%	7.0%	9.0%	9.4%
Russell 1000 Value Index	9.0%	9.0%	20.3%	8.1%	10.3%	9.0%
S&P 500 Index	10.6%	10.6%	29.9%	11.5%	15.1%	12.9%

Inception: 9/30/2014

PORTFOLIO REVIEW

Equity markets had a strong start to the year with the S&P 500 Index gaining 10.6% and the Russell 1000 Value index posting a 9.0% increase. After a somewhat tepid January market performance in which the narrow 2023 leadership largely continued, the last two months of the quarter saw equity markets advance, broaden and gain momentum. Data releases throughout the first quarter continued to indicate that the domestic economy remains in growth mode and that inflation pressures persist. This has led some aggressive investors to alter the number and timing of expected rate cuts from the Federal Reserve this year. These renewed expectations pressured some areas of the market early this year, but more data readings on the positive side of the ledger have led to broader investor optimism about economic growth prospects.

The case for a soft-landing economic scenario has grown, and more recently there has been commentary of a 'no landing' situation in which growth is above trend going forward. None of this is reflected in 2024 earnings estimates for the S&P 500, which have not materially moved since the end of December. Investors will be eagerly anticipating management outlooks during the upcoming quarterly earnings reports to see if analyst estimates are in line with company commentary.

Fourth quarter earnings came in better than expected and management guidance was generally cautious but with a tinge of optimism for the year. This firmer backdrop caused cyclical sectors like industrials, materials, energy and consumer discretionary to gain favor in late February and March. This broadening of investor money flows beyond tech and artificial-intelligence-related stocks is healthy for markets and necessary after the concentrated index moves over the last year.

Low- and no- dividend yield stocks in the Russell 1000 Value were strong index leaders versus companies with higher dividends which significantly underperformed. Since the Equity Income Strategy only holds companies that pay a dividend, the benchmark is not necessarily a good comparison in this backdrop. Though it is accepted as the industry standard, the Russell 1000 Value Index is not a true dividend benchmark, unfortunately. The strategy's 2.6% dividend yield continues to be above the benchmark's 2.1% yield and remains much greater than the S&P 500's 1.4% yield.

The benchmark's best performance was generated in the energy (+14%), financials (+13%) and industrials (+12%) sectors. Those cyclical sectors are generally perceived to benefit from an improving growth backdrop. Additionally, rising oil prices boosted energy stocks and financials gained favor as sentiment moved toward fewer expected interest rate cuts over the coming quarters. Lagging areas were bond proxy sectors real estate (-1%) and utilities (+5%), along with the defensive healthcare (+6%) sector.

Relative outperformance for the Equity Income Strategy was generated in real estate (-5% vs. -1%), due to being underweight the sector, and in consumer staples (9% vs. 7%). Our staples return was aided by rebounds in Target (+25%) and Dollar General (+15%). Underperformance was observed in the industrial (4% vs. 12%) and financials (10% vs. 13%) sectors. Robert Half (-9%) issued weak first quarter temporary staffing guidance but expects the year to get better from there. United Parcel Service (-4%) also provided conservative margin guidance out to 2026 that disappointed investors.

PORTFOLIO CHANGES

During the first quarter there were no additions and only one elimination made to the portfolio. *Coca-Cola Company* was sold due to concerns that price increases over the past few years may continue to negatively impact volume growth and lead to margin compression.

TOP CONTRIBUTORS

JPMorgan Chase & Co. is benefiting from improving net interest income expectations, anticipation of a capital markets recovery, strong capital building and still-healthy credit metrics. This caused EPS estimates to improve and the stock's valuation multiples to expand.

Eaton Corp., a leading diversified industrial manufacturer, continues to see strong demand with mega projects expected to drive significant market opportunities over the next few years. A strong backlog provides visibility as management invests for additional future growth.

Merck & Co, a large pharmaceutical manufacturer, posted strong results helped by its blockbuster Keytruda cancer treatment drug. The drug pipeline has broadened as more molecules advance through clinical trial stages and investor expectations for a new cardiovascular drug (sotatercept) have firmed. The announced acquisition of Harpoon Therapeutics will also bolter the oncology pipeline.

Travelers Companies, Inc., a property and casualty insurer, reported strong fourth quarter results driven by healthy premium growth and a notable improvement in the company's combined ratio. Policy rates are growing faster than loss cost trends which should translate to further margin improvement.

Target generated above consensus margin expansion and delivered a big EPS beat, driven in part by lower transportation costs and less promotional activity, which helped to improve gross margins for the company. The company also reported that inventories had reached a more optimal level, after a period of excess inventory.

Top Detractors

Xcel Energy, an electric utilities company, acknowledged its facilities were involved in the ignition of the Texas Smokehouse Creek Fire but disputes claims that it acted negligently, which is a key point in determining liability in Texas. Xcel's financial exposure has been estimated in the range of $2-5 billion. Wildfire risk is an issue that utilities are focused on addressing with industry-wide proposals and reforms.

Robert Half, a temporary staffing company, reported better than expected results in a slowing staffing backdrop. The downward industry trend continued into 2024 as the company the company issued first quarter guidance that is down from the prior year. Sequential improvement is expected through the rest of 2024.

Air Products and Chemicals, a materials company that provides process and specialty gases, suffered a quarterly miss versus investors' expectations as the more cyclical merchant gas business was bedeviled by weak Chinese demand, especially from electronics manufacturing customers.

UnitedHealth Group, a health insurer, physician group owner, and physician services provider, missed quarterly operating profit expectations due to higher medical claim expenses that were driven by an increase in elective procedures and doctor visits. 2024 guidance was not changed, but investor anxiety increased regarding a lower-than-expected initial 2024 Medicare Advantage reimbursement rate proposal that will likely be revised upward. The Department of Justice also announced an anti-trust investigation into the company's business units and its vertically integrated business model. UNH also experienced a cyber security issue at its Change Healthcare unit in the quarter.

Realty Income, a real estate investment trust, is being negatively impacted as its cost of capital is increasing at a faster pace than the cash flow yields of the properties it is acquiring. This dynamic is causing a slowdown in profit growth.

Portfolio Outlook

The Federal Open Market Committee meeting in March gave investors more confidence that rate cuts are coming, despite inflation data in January and February that was hotter than expected. Only time will tell if inflation is stickier than anticipated or if the recent data are just bumps along the road. The Federal Reserve appears to be in a wait and see mode with a bias toward rate cuts, though not as many cuts as some pundits projected at the end of last year. Given the economy's continued strength and the Fed's expectation that inflation will continue to slow, it seems the Fed doesn't believe a recession is necessary to bring down inflation.

Investors were bolstered by this and the increase in the Fed's 2024 GDP growth projection, moving from 1.4% to 2.1%. On this news, markets moved higher following the Fed's press conference. The S&P 500's 10.6% return in the quarter was driven by better-than-expected earnings and strong margins. These results, improving corporate sentiment and solid economic data have supported the soft- or no-landing narratives, and have replaced the mindset that only Fed rate cuts could fuel equity gains. A healthy economy could do the same.

Though widely expected, we anticipate that the first cut in interest rates will be embraced by investors. Lower rates may also beget increased M&A and IPO activity. Companies and investors have shown a pent-up appetite for these transactions as exhibited by the recent deals Capital One and Home Depot have made and the IPOs of Reddit and Astera Labs. These transactions may also hint at the strengthening confidence in the U.S. economy. If recession fears continue to fade, the labor force remains strong, inflation doesn't reaccelerate and the economy continues to march forward, markets should have good reason to continue moving higher.

The domestic economic outlook is attractive at this time and should be supportive of equities. However, just like the NCAA March Madness tournament, there is always the potential for spoilers. If inflation or economic growth continue to surpass the Fed's expectations, they may not deliver the rate cuts that are expected, which may cause investors to be more cautious. There has been unprecedented monetary tightening this cycle, which works with long lags. The November elections could also give investors a reason to pause as economic and regulatory policy may change dramatically depending on who is in control of Congress and the White House. Global tensions could also derail markets. Often, it seems the spoiler is one that few investors have in focus. Large cap equities have had a strong, uninterrupted upward move off last October's lows. So, it would not be surprising if the markets found cause for a breather sometime soon.

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While we are well aware of the domestic and global issues that can move markets, we stay focused on what will drive the intrinsic value of our holdings over the coming years. Our strategy is populated with high quality companies possessing attractive valuations. These are the building blocks of investing that put our portfolio and our clients' capital in a strong position for the future.

Unless otherwise noted, all returns, excluding Tributary Capital Management's strategies, have been obtained from FactSet Research Systems. Sector and security level performance is presented net of fees, using the highest potential fee an investor would pay.

The performance numbers shown above are for the Tributary Equity Income Composite and are expressed in U.S. dollars. The composite includes all discretionary accounts with an initial market value of $500,000 (effective 7/1/20) that are generally invested in the Equity Income Strategy. The inception date of the Equity Income Composite is September 30, 2014.

The S&P 500 Index is a basket of 500 stocks that is weighted by market value, and its performance is thought to be representative of the stock market as a whole. The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The Russell 1000 Growth Index measures the performance of the large cap growth segment of the US equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. It is not possible to invest directly in the S&P 500, the Russell 1000 Index or the Russell 1000 Growth Index.

Net-of-fees composite returns are calculated using the highest potential fee the investment advisor will charge investors in the composite. Net performance is reported net of investment advisory fees and transaction costs. Capital gains and dividends are reinvested for performance calculations.

It should not be assumed that an investment in securities identified was or will be profitable or that the investment decisions we make in the future will be profitable or will equal the performance of the securities discussed herein. Holdings are subject to change. The holdings identified do not represent all of the securities purchased, sold or recommended for the portfolio. The holdings listed should not be considered recommendations to purchase or sell a particular security. The "Top Contributors" and "Top Detractors" represented are based on contribution to portfolio return. To obtain the contribution calculation methodology and a complete list of every holding's contribution to the overall portfolio's performance during the quarter, please contact clientservices@tributarycapital.com. Sector performance in commentary is stated gross of fees.

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