RS CONCENTRATED ALL CAP VALUE STRATEGY QUARTERLY COMMENTARY

RS Investments®
A VICTORY CAPITAL® INVESTMENT FRANCHISE

As of June 30, 2022

Market Commentary

The first half of 2022 has been an interesting period, to say the least. With several broad market averages slipping into bear territory in the second quarter, investors are left pondering a host of questions. Just how healthy is the economy? Is the Federal Reserve on the verge of tightening monetary policy so much that it causes the economy to grind to a halt? Does the near-record-low unemployment rate reflect underlying economic strength, or are the recently announced layoffs across the tech industry a sign of things to come? Is Russia's invasion of Ukraine the beginning of a more dire global war, or does it reflect developed nations truly coming together for the first time to protect freedom? Are stocks cheap, given that multiples have (in some cases) hit their lowest point since the global financial crisis more than a decade ago, or do these multiples reflect future earnings that won't be achievable? It's tricky out there.

Although nobody can answer these questions with absolute certainty, we can definitively say that the current investment landscape is as polarizing as we have seen in years, and global markets have reflected this uncertainty with extreme bouts of volatility. Perhaps most troublesome to markets are inflation concerns and the Fed's subsequent monetary policy shift. On one hand, the Fed is right to be worried given that we've seen some of the highest year-over-year Consumer Price Index readings in decades. Already we've seen several aggressive bumps in the federal funds rate for the first time in years, and several more appear to be on the way. This indicates the Fed's willingness to aggressively combat inflation irrespective of the impact on the underlying economy. While global equity markets have pulled back, it's perhaps more notable that the rising rate backdrop has pushed the Bloomberg U.S. Aggregate Bond Index to its worst two quarters since 1980.

Of course, it was no picnic for equity investors either during the second quarter, though it's worth noting that Value as an investment style continued to outperform Growth. In fact, one of the key underlying themes for equity markets to start the year has been how value-oriented stocks with pricing power, such as those within the energy, utilities, or consumer staples sectors, have materially outperformed growth-oriented stocks. This trend remains mostly intact, perhaps reflecting the higher interest rate environment and corresponding higher borrowing costs facing many fast growers that only offer the promise of future earnings. Still, in terms of absolute numbers, there were not many places to hide even for Value investors. Sentiment has soured, and the Russell 3000® Value Index declined 13.2% during the second quarter of 2022, which is approximately 21% off its all-time high achieved near the beginning of 2022. As we all were reminded once again, things can change quickly in this business.

Whether the Fed can help bring down inflation without tanking the economy is anyone's guess. We believe this will continue to be the most important issue weighing on markets going forward. Global logistics that were already challenged by the pandemic are under even more pressure due to Russia's invasion of Ukraine. Energy and commodity markets have been disrupted and continue to have a detrimental effect on supply chains around the world. Many companies have had difficulty gauging demand while navigating the challenging supply chain logistics. For example, several high-profile retailers recently reported that they are now sitting on excess inventory. Oddly enough, this may actually help ease pricing pressure and provide some relief for consumers in the near term.

Although challenges persist, it's not all doom and gloom and there are some reasons for optimism. An uptick in COVID-19 cases in the United States this spring was not met with higher hospitalizations or deaths, meaning we've likely seen the true transition of the coronavirus from pandemic to endemic. Many companies, particularly those with astute management teams and pricing power, appear positioned to do well in the face of this challenging macro environment. Thus, while periods of elevated volatility may continue, we see the pockets of underlying economic strength that are being ignored. Coupled with the more attractive valuations, we see some potentially intriguing buying opportunities that could benefit patient, long-term investors.

Performance Review

For the three months ended June 30, 2022, the RS Concentrated All Cap Value strategy outperformed its benchmark Russell 3000® Value Index (the "Index") and returned -6.76% net versus a return of -12.41 % for the Index.

In the second quarter, performance was bolstered by stock selection in the Financials and Materials sectors, which was partially offset by performance in Energy and Consumer Staples.

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 Return on Invested Capital (ROIC)–focused investors and seek to invest in companies that 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 return on invested capital (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 are able to navigate through short-term market volatility and appear poised to deliver long-term shareholder value.

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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 higher 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 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. 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.

Vistra Corp. (VST) is an integrated power company that both produces and sells electricity in markets across the United States, although the majority of its operations are located in the state of Texas. Vistra produces electricity with natural gas and coal power plants, along with carbon-friendly nuclear, solar and battery facilities. The company sells power to residential and commercial customers through its retail marketing businesses. By having both generation and retail businesses, VST is able to reduce the fluctuations in its cash flow as it is able to manage the spread between the cost to purchase electricity and the retail price to the consumer – it is not caught long or short in any meaningful quantities or in price.

We purchased Vistra as we believed their business model dramatically reduced the risk of the wild swings in cash flow that power producers experienced prior to controlling significant retail businesses and that the company would be able to sustain a high ROIC throughout a cycle. Further, VST produces a large amount of excess capital, which we thought would be deployed in a shareholder-friendly manner involving dividends, share repurchases, and debt reduction. VST is executing on increasing its renewable portfolio of solar and battery projects while closing uneconomic coal plants, providing a new avenue for growth for the company. High natural gas prices further help the company, as its power fleet becomes more profitable in those conditions. We feel that VST will continue to raise the dividend and buy back shares for many years to come and create meaningful shareholder value for our funds.

NCR Corporation (NCR), a leading provider of software, hardware and services for banks, retailers, restaurants and small businesses, declined 23% during the second quarter. The stock underperformed due to weak guidance for 2022 given by management due to four primary headwinds: cost inflation, COVID-19, the Ukraine war, and higher interest rates.

Roughly half of $150M in projected 2022 EBITDA headwinds came from component, freight, and fuel cost increases primarily hitting its hardware products, including automated teller machines (ATMs) for banks, point-of-sale (POS) solutions for restaurants and retailers, and self-service checkout kiosks at grocery stores. Management expects to fully recoup this loss over the course of the year through price increases and cost cuts. An additional $35M from COVID lockdowns, $15M from the Ukraine war, and $25M from increased interest rates will not be recouped, leading to a $75M net EBITDA headwind this year.

Last quarter, management initiated a strategic review to unlock shareholder value. Recently, Bloomberg revealed that six parties expressed interest in bidding for NCR, and we believe an acquisition of NCR is reasonably likely. However, even if NCR remains independent, we agree with management that the company is severely undervalued, so we continue to hold our position.

Outlook

2022 is setting up to be a pivotal year. Much will depend on how successful the Federal Reserve is at transitioning from an ultra-stimulative posture to a much less accommodative one (the elusive soft landing), while the U.S. and the rest of the world are dealing with the impacts of Russia's invasion of Ukraine. The U.S. consumer remains resilient, with healthy balance sheets following trillions in fiscal stimulus. The impacts from the COVID-19 pandemic are waning, and immunity resulting from prior infections, increasing vaccinations, and release of antivirals should help further the reopening of our economy.

Interest and mortgage rates have lifted off historically low levels, with 30-year mortgage rates recently topping 5% – potentially a psychologically important level. We are seeing reflation in many areas of the economy and are watching this closely given the historically high levels of government spending here and around the world. Unemployment has shown significant improvement, but labor continues to be an issue as the participation rate continues to be low and labor shortages are impacting many industries.

In our estimation, overall equity valuations remain at elevated levels. Treasury and high-grade corporate bond yields look unattractive. In any case, we believe value investing is ripe for a period of outperformance. Meanwhile, we still believe equities represent a superior asset allocation alternative to bonds over the longer term.

We thank you, as always, for your support.

Sincerely,

RS Value Team

Top Contributors (Representative Account)
As of June 30, 2022

Holding	% Contribution to Return
White Mountains Insurance Group	0.44
Cigna Corporation	0.38
Humana Inc.	0.32
Merck & Co., Inc.	0.24
LKQ Corporation	0.23

Top Detractors (Representative Account)
As of June 30, 2022

Holding	% Contribution to Return
Willis Towers Watson Public Limited	-0.78
NCR Corporation	-0.65
Meta Platforms Inc. Class A	-0.64
Comerica Incorporated	-0.63
PDC Energy, Inc.	-0.51

Composite Performance
Average Annual Returns as of June 30, 2022

RS Concentrated All Cap Value Composite	Second Quarter 2022	1-Year	3-Year	5-Year	10-Year	Since Inception*
Gross of fees	-6.56%	1.76%	8.67%	9.57%	12.62%	9.75%
Net of fees	-6.76%	0.89%	7.75%	8.65%	11.62%	8.72%
Russell 3000® Value Index	-12.41%	-7.46%	6.82%	7.01%	10.39%	7.26%

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. *06/30/2005.

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. Interested parties are strongly encouraged to seek advice from qualified tax and financial experts regarding the best options for your particular circumstances. 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 3000® Value Index is a market-capitalization-weighted index that measures the performance of those companies in the Russell 3000® Index with lower price-to-book ratios and lower forecasted growth values.

The RS Concentrated All Cap Value Strategy primarily invests in a diversified portfolio of small-cap, mid-cap, and large-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.

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