

Manager's Commentary

Aman Budhwar, CFA

Highlights

- The US consumer is increasingly under pressure from a combination of higher inflation and lower job opportunities. While the market is fixated on a potential Fed rate cut, we have positioned the portfolio to benefit from opportunities over the medium to long term.

The S&P MidCap 400 Index posted total returns of 3.6% for the month of August 2025, outperforming its large cap peer, the S&P 500 Index by 156bps. On a year-to-date basis, the MidCap Index, with total returns of 5.2%, has lagged the S&P 500 Index by 560bps, creating an attractive investment opportunity in the mid cap space with a forward price to earnings multiple of 17x, a 6.0x turn discount to its larger cap peer. The operating cash flow yield for the MidCap Index is also attractive at 5% vs 3% for the large cap index.

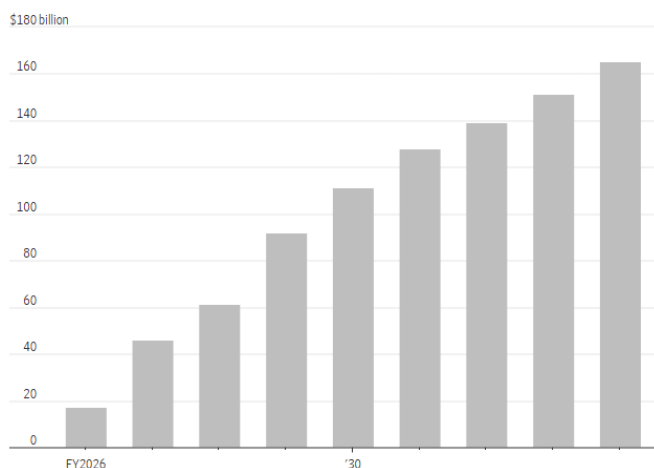
Growing consumer angst

At the time of writing, the next Fed meeting is still over a week away, but the market seems to have come around to the view that rate cuts are coming. The most recent data point in the form of the Labor Department's job report showed a slowing job market, with just 22,000 new jobs created in August and an increase in the unemployment rate to 4.3%.

The US has added just 598,000 jobs so far in 2025. Outside of 2020, when the pandemic hit, that is the lowest for the first 8 months of a year since 2009, when the economy was buckled by the financial crisis. In fact, outside of Health Services, which added roughly 64,000 jobs each month, the remainder of the private sector has been contributing only about 9,400 jobs per month.

Further, the Bureau of Labor Statistics reported that the pace of job growth for the 12-month period ending in early 2025 was likely significantly weaker with the US adding 911,000 fewer jobs than previously reported. If that holds, it will bring the average pace of monthly employment gains from 147,000 jobs over the period to about 71,000.

Projected federal Medicaid cuts, by year



In the future, cuts to government health spending are also likely to weigh on hiring. As a result of President Trump's "one big, beautiful bill", Medicaid spending will be reduced by \$911 billion, increasing the number of uninsured by 10 million over the 10 fiscal years ending in 2034, according to an analysis of Congressional Budget Office estimates conducted by health-research nonprofit KFF. Those cuts are heavily backloaded—in fiscal 2026, which starts on

Source: KFF

October 1, they amount to \$17 billion, versus \$165 billion in 2034¹.

Another concern for people buying their own health insurance from the Affordable Care Act (ACA) marketplace is that they are likely to pay significantly more next year. Health insurers have seen a rapid increase in costs in 2025 and as a result are seeking hefty 2026 rate increases. For example, Blue Cross and Blue Shield of Illinois want a 27% hike while its sister Blue Cross in Texas is asking for 21%². On top of that, premium tax credits passed by Congress in 2021 are to lapse at the end of December 2025 unless renewed by Congress, leading to increased premiums and an estimated 4 mln drop in enrollment.

Notable portfolio developments

Alongside the lack of job growth, consumers, who are still feeling pinched from the recent run of inflation, are worried that new tariffs are starting to trickle through the economy.

In its most recent earnings call for the quarter ended August 2, 2025, **Dollar Tree Inc. (DLTR)** management noted the volatile backdrop for the retail industry as the economy continues to adjust to elevated tariffs, persistent cost pressures and a static labor market. In this environment, consumers are seeking value and convenience more than ever, and Dollar Tree is uniquely positioned to deliver both.

Dollar Tree reported 6.5% same store sales growth in the quarter, outperforming its guidance and gaining market share by expanding its relevance to a broader base of customers. At quarter end, Dollar Tree added 2.4 million new customers on a trailing 12-month basis and nearly 2/3rd of those new customers came from households earning \$100,000 or more. Dollar Tree has been expanding its product assortment by converting stores to its multi-price format (almost 40% of the 9,148 stores at quarter end have converted), increasing its flexibility to respond to tariffs and other cost pressures while still offering tremendous value with 85% of products priced under \$2.

However, management painted a cautious outlook for the back half of the year because, as they put it, over the past four to five years, prices have increased significantly across the entire retail landscape, and the full impact of tariffs is still unknown. Management highlighted five levers to mitigate these cost pressures – negotiating with suppliers, shifting country of origin, dropping noneconomic SKUs, re-spec'ing products and finally, as a last resort, pricing.

Another of our retail-facing portfolio companies, **Estee Lauder Companies Inc. (EL)**, recently presented at a conference and talked about the pressures the consumers around the world leading them to reposition some products by offering small sizes or through innovation, bringing products at more accessible price points, to help consumers reengage with the brand. After a long time, they have been able to gain market share in the Americas driven by consumer-facing marketing investments as well as expanding consumer coverage by launching new brands on Amazon, a channel that has been overlooked in the past.

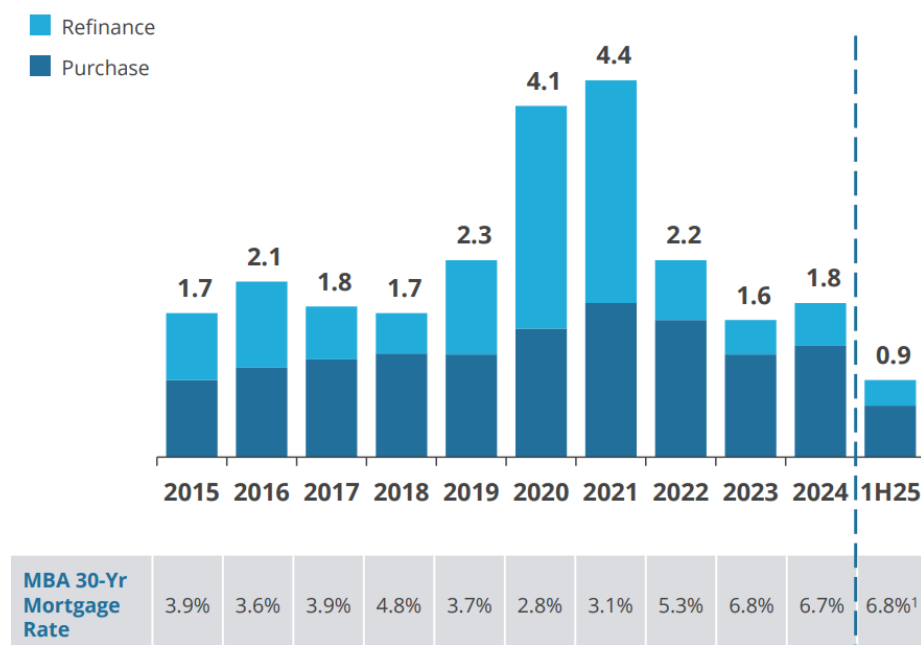
Another market where the fallout of recent less-than-stellar economic reports is being felt is the mortgage market where 30-year mortgage rates dropped sharply following the release of

¹ [Healthcare Jobs Are a Rare Bright Spot in the Stalling Labor Market](#) – The Wall Street Journal – September 8, 2025

² [Obamacare Insurers Seek Double-Digit Premium Hikes Next Year](#) – The Wall Street Journal – July 18, 2025

the weaker-than-expected jobs report. The average rate for a 30-year fixed mortgage fell to 6.29%, the lowest level since October and down 16 basis points from a day earlier, according to Mortgage News Daily, a tracker of home-lending rates.

Industry Mortgage Originations (\$Trillions)



¹MBA July 2025 Housing Forecast

Fidelity National Financial Inc. (FNF) is a leading provider of title insurance and transaction services to the real estate and mortgage industries with a 32% share of the \$16 billion annual revenue generated by the residential purchase, refinance and commercial market in 2024. After stellar performance in 2020-21, when 30-year mortgage rates reached a low of less than 3%, the mortgage originations market (purchase and refinance) has been subdued for the last couple of years as 30-

year mortgage rates have fluctuated between 6% and 8%. A recovery in the market from recent lows should help both FNFs topline and margins (FY24 revenue for the title business was down 33% and pre-tax margin -660 bps vs 2021)³, especially as it pertains to refinance transactions.

New position

International Flavors and Fragrances (IFF) is a leading creator and manufacturer of food, beverage, health and biosciences, scent and complementary adjacent products including natural health ingredients which are used in a wide variety of consumer products. The business is geographically diverse, with the US representing 28% of sales in 2024 and no other country representing more than 10% of sales. Under the leadership of J. Erik Fyrwald, CEO since February 2024, the company has taken significant steps to reduce leverage and focus the business on differentiated products with opportunity for innovation to enhance margins. This includes cutting the dividend per share by 50% to \$0.40 per quarter in the second quarter of 2024, sale of the Pharma Solutions business for an enterprise value of \$2.85 billion and other smaller divestitures. At the same time, management has decided to increase capex to around 6% of sales (vs 4% previously), with around half targeted at

³ [Fidelity National Financial Investor Update](#) – Summer 2025

maintenance and the rest split between deferred investment catch up and growth investments. A renewed focus on innovation is seeing more investment into R&D that is expected to accelerate growth in the next couple of years. With leverage below the targeted 3x Net debt / EBDITA at the end of Q22025, management has communicated a willingness to restart share repurchases beginning with the fourth quarter of 2025. At a minimum, this program is designed to offset annual dilution from equity compensation (around \$75 million to \$100 million per year), with the flexibility to increase repurchases as free cash flow generation increases and when IFF shares are trading below intrinsic value. We believe the shares offer attractive value at current levels as the market is yet to price in an improving return on capital outlook driven by a focus on core competence and differentiated, high margin products with above average growth outlook⁴.

Outlook

After trailing the large cap index for most of the year, the S&P MidCap 400 Index outperformed the S&P 500 Index in the month of August, and this relative outperformance is likely to continue if we get the Fed rate cuts that the market expects next week. Small caps typically carry more debt making them more responsive to lower interest rates and improved access to credit.

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⁴ [International Flavors & Fragrances Annual Report 2024](#)