

Enhanced Equity Income Q2 2025 Commentary

Market Review:

US equities rallied in the 2nd quarter, with the S&P 500 gaining 10.9% while the Russell 1000 Value was up 3.8%. It was a tumultuous start to the quarter, when President Trump announced his April 2nd “Liberation Day” reciprocal tariffs that were far more sweeping and extensive than equity markets had expected. Equities worldwide reacted swiftly, with the S&P 500 dropping 11% over just three trading days. Additional signs of stress across the US financial system, including a sell-off in US Treasuries and a decline in the US dollar, likely influenced the Trump administration to pause reciprocal tariffs on April 9th for 90 days.

Stocks rallied in response to the 90-day pause, which applied to all countries except China. On May 12th, the US and China announced their own 90-day pause, with the US reducing tariffs on Chinese goods to 30% from 145%, and China lowering tariffs on US goods to 10% from 125%. The temporary truce between the world’s two largest economies further boosted the stock rally, resulting in the best performing month of May since 1990. Throughout June, conflict in the Middle East threatened to end the global equity rally. However, following US airstrikes on Iranian nuclear facilities, a ceasefire between Israel and Iran quelled fears of further military conflict. By the end of the quarter, the S&P 500 reached a new all-time high, its first since February. It was the fastest ever recovery back to a new high for the index after a decline of at least 15% from a previous all-time high (Figure 1).

Figure 1: S&P 500 Fastest Recoveries Following a Decline of at Least 15%

All-Time High Date	Trough Date	Recovery Date	% Decline at Trough	Trading Days to Recover
2/13/1980	3/27/1980	7/14/1980	-17.1%	104
7/16/1990	10/11/1990	2/13/1991	-19.9%	148
7/17/1998	8/31/1998	11/23/1998	-19.3%	90
9/20/2018	12/24/2018	4/23/2019	-19.8%	146
2/19/2020	3/23/2020	8/18/2020	-33.9%	126
2/19/2025	4/8/2025	6/27/2025	-18.9%	89

Source: Ned Davis Research, 06/30/2025.

The US federal budget was also a focal point for investors throughout the quarter. The Republican controlled House of Representatives passed a comprehensive budget bill encompassing tax reforms, spending adjustments and policy changes. Among other provisions, the bill included an extension of the 2017 tax cuts that were set to expire in 2025, the elimination of several clean energy tax credits, changes to Medicaid eligibility, and a significant increase in Defense spending. Moody’s downgraded the US sovereign credit rating from Aaa to Aa1, influenced by concerns over the nation’s escalating debt levels and rising interest payment obligations, as well as the lack of effective measures to reverse the trend of large annual deficits. The budget uncertainty, tariff uncertainty and expectations that the Fed could cut interest rates in the 2nd half of the year sent the US dollar lower. It was the worst first half of a year for the US dollar since 1973, with the dollar index declining 10.7%.

Information Technology (+23.7%) and Communication Services (+18.5%) were the two best performing sectors, after being two of the worst performers in the 1st quarter. Given the number of technology firms that manufacture products in China and other Asian countries, the sectors declined sharply on Trump's initial tariff announcement but rallied through the remainder of the quarter on the easing of tariff concerns. Industrials (+13.0%) was the 3rd best performer, driven partly by provisions in the Congressional budget bill that will allow for the immediate expensing of capital expenditures, an accounting change that would particularly benefit industrials and other capital-intensive companies. Energy (-8.6%) was the worst performing sector, whipsawed by extreme volatility in oil prices. Oil declined following the announcement of the reciprocal tariffs, then surged 30% as geopolitical tensions in the Middle East escalated and finally declined nearly 15% after the Israel-Iran ceasefire. Healthcare (7.2%) was the next worst performer, partly on President Trump's "most favored nation" initiative, which aims to link prices paid for US pharmaceuticals to other developed nations.

Income and Options Summary:

The strategy's representative account annualized a 7.4% total yield at quarter end. During the quarter, income was impacted by fewer call writing opportunities available in bond proxies and defensive names. However, the 33 positions exposed for coverage exhibited strong characteristics, opening at an average 17.5% annualized premium and 85% annualized total return, written 4.5% out-of-the money.

Other income data improved. The 3.3% year-to-date premium income figure recorded included a reduction in the assignment rate to 34%. Dividends remained strong at a 4.2% annualized yield. Dividend increases improved to 5%, declared by 15 of the 33 active holdings in the portfolio.

Performance Analysis:

For style preference, the second-quarter broad market performance was nearly a mirror image of the first quarter's. By the first week of April, the preference for growth-style names had returned, again in the "quality earnings/momentum" factor set, which excludes most value style and high-dividend names by rubric. By late June, Growth passed Value in year-to-date total return. Reports of heightened retail investor interest were underscored by speculation, with growing short positions against many names in the strategy.

Figure 2: S&P 500 Performance by Dividend Quintile

S&P Dividend Yield Quintiles		Q2	YTD	2024	2023	2022	BofA Adj Beta	Forward P/E Ratio	Dividend Yield
Low Yield ↓	0.00 To 0.02	14.19	5.2	32.7	51.0	-37.2	1.26	31	0.0
	0.02 To 1.09	16.96	5.9	32.2	39.8	-25.0	1.17	27	0.5
	1.09 To 2.00	5.99	4.9	17.1	14.1	-10.3	1.00	17	1.6
	2.00 To 3.31	3.59	6.0	9.4	2.6	-11.5	0.88	18	2.6
High Yield	3.31 To 10.57	-3.73	3.9	14.5	-0.8	6.9	0.77	13	4.3
S&P 500		10.57	5.5	23.3	24.2	-19.4	1.09	22	1.2

Source: BofA/ML, US Performance Monitor, 06/30/2025. **Past performance is no guarantee of future results.**
Distribution of S&P 500 as of 6/30/2025 (Quintiles are held and re-balanced monthly).
Investors cannot invest directly in an index.

Although sector interest broadened somewhat, compared with the Magnificent 7¹ period, the predictable outperformance of the momentum sectors, Information Technology, Consumer Discretionary, and Communications Services, persevered with the rally. Near quarter-end, 68% of the names in the Russell 3000 Index were down from their one-year highs by 15% or more. And in a change that succinctly summarized investor sentiment, Amazon, Alphabet, and Meta were added to the Russell 1000 Value Index.

Figure 3: Enhanced Equity Income Returns vs. Benchmark

June 30, 2025	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Incept*
SCCM Enhanced Equity Composite (gross)	-0.9	5.1	10.4	8.0	11.3	8.0	8.8
SCCM Enhanced Equity Composite (net)	-1.2	4.5	9.1	6.8	10.1	6.7	7.6
S&P 500 Buy-Write Index (BXM)	1.9	-1.3	10.2	9.4	10.2	6.4	6.7
SPDR Bloomberg High Yield Bond ETF (JNK)	3.7	4.5	9.8	9.3	5.1	4.2	4.8
Russell 1000 Value Index	3.8	6.0	13.7	12.8	13.9	9.2	10.5

**12/31/2010. Performance for periods greater than 1 year is annualized. Past performance is no guarantee of future results. Value of portfolio will fluctuate based on underlying securities. Current performance may be higher or lower than stated returns. Fees vary by size of account. Please see ending page for complete performance disclosures.*

The strategy's composite underperformed both of its benchmarks during the 2nd quarter, netting -1.2%, compared with a 1.9% return by the S&P 500 Buy-Write Index (BXM) and 3.7% by the SPDR Bloomberg High Yield Bond ETF (JNK). EEI continued to outpace the BXM year-to-date, as that Index likely remained truncated by its systematic options strategy. Enhanced also marked slightly ahead of JNK, despite a strong High-Yield Bond rally during the quarter. The strategy's returns were buoyed by a strong outperformance in its Financials allocations and contributions from its Materials and Real Estate holdings limited negative performance.

Portfolio Changes:

Purchases/Additions

Paccar (PCAR) – The stock was purchased in the strategy in the quarter. Paccar is a manufacturer and distributor of trucks and aftermarket parts. It is a global technology leader with advanced powertrain technologies, leading brands (Kenworth, Peterbilt) and a favorable manufacturing footprint. The company has a diversified business model with exposure to high-margin aftermarket parts and demand should be supported by increased infrastructure spending. While the impact of uncertainties and tariffs result in a more muted short-term growth outlook, management expects margins to gradually improve over the year as price versus cost re-balances. The company's inventory level is at 3 months, which is below historical averages and industry peers, positioning the company for an industry upturn. Paccar trades at an attractive valuation – 14x 2026 EPS, 2.7x book value with a 3.8% dividend yield.

PPG Industries (PPG) – Shares of PPG were purchased in the quarter. PPG is a leading global manufacturer of paints, coatings, and specialty materials serving diverse end markets, including aerospace, automotive, industrial, packaging, and construction. PPG represents an attractive investment opportunity

¹ The Magnificent 7 stocks are a group of high-performing and influential companies in the US stock market: Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla.

due to its diversified revenue streams, strong innovation pipeline, and potential for earnings recovery. The company's focus on value-enhancing acquisitions, disciplined cost management, and exposure to high-growth end markets positions it well for long-term success. While macroeconomic headwinds persist, PPG's pricing power, cost control measures, and aerospace/industrial recovery provide earnings support.

ConocoPhillips (COP) – The stock was purchased in the strategy during the quarter. ConocoPhillips is a leading independent exploration and production company with a global portfolio of low-cost, high-return assets and a disciplined capital allocation strategy. The company is approaching a free cash flow inflection as capital spending on major long-cycle projects begins to roll off in 2H25, improving its ability to return capital to shareholders. Management targets returning approximately 45% of operating cash flow through dividends and buybacks, supported by efficiency gains and a strong balance sheet. COP trades at 14.4x 2025 EPS and offers an ~8% capital return yield, presenting an attractive entry point amid a constructive long-term oil backdrop.

Norfolk Southern (NSC) – Shares of NSC were purchased in the strategy. With origins dating to 1827, NSC owns and operates a rail network spanning 19,200 route miles and 22 states. From late 2022 through early 2025, the transports industry experienced a freight downturn with a consistent decline in shipment volumes due to destocking and a drop in consumer demand from the pandemic highs. Rail intermodal was hit particularly hard, with 2024 industrywide intermodal volumes down roughly 10% from 2022. However, volumes have begun to recover in 2025, with weekly rail traffic up mid-single digits from a year ago. While concerns remain surrounding the impact of tariffs and global trade fluctuations, NSC should be resilient given its strong presence in the Eastern US connecting 60% of the country's consumer base and manufacturing base. Importantly, NSC's operating ratio (OR), a primary measure of rail efficiency, significantly lags that of major peers, with adjusted OR's in mid- to high 60s versus peers in the low 60s or high 50s percentiles. Increasing efficiency and lowering the OR is a primary goal of Mark George, who took over as CEO in September 2024. Through the implementation of precision scheduled railroading (PSR), Mr. George and his team believe NSC can achieve a low-60s OR in the medium term and a below 60 OR over the longer term. Shares of NSC were purchased at a P/E of 16.8x with a 2.3% dividend yield.

Sales/Trims

Dow (DOW) – Our position in DOW was sold during the quarter. The company has been hurt by a down market in construction, manufacturing, and automotive markets, which has been exacerbated by trade tensions in the past few months. Management has announced several actions to improve cash flow, including \$2.4 billion of asset sales, a \$1 billion capex reduction, and a >\$1 billion settlement from a years-long lawsuit. While we continue to see considerable upside in the stock once its end markets recover, the timing remains uncertain.

Johnson Controls (JCI) – Our position in JCI was called away and not repurchased. The stock had been a long-term holding but appreciated substantially over the past year, benefiting from its exposure to data center construction and from its own internal operational improvements. Moreover, investors are excited about new CEO Joakim Weidemanis and his vision to improve the service offering. While we continue to believe in the company's strong and improving fundamentals, the valuation now reflects that positive outlook. Given the price appreciation, the stock's P/E multiple has expanded to 29x and the dividend yield has fallen to 1.4%.

RTX (RTX) – Our position in RTX was called away and not repurchased. The stock had been a long-term holding but has appreciated substantially over the past year, benefiting from its exposure to increasing defense budgets and RTX's particular exposure to missile defense systems, one of the most in-demand

defense products. Moreover, the company has managed its GTF engine recall and well-mitigated the risks. While we continue to believe in the company's strong and improving fundamentals, the valuation now reflects that positive outlook. Given the price appreciation, the stock's P/E multiple has expanded to 25x and the dividend yield has fallen to 1.8%.

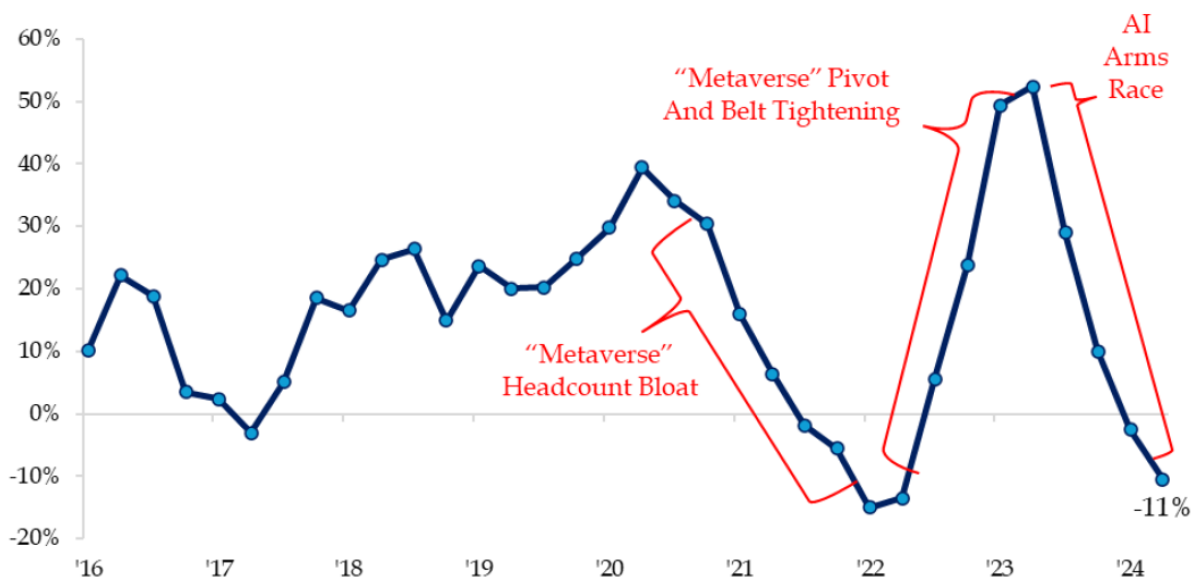
Chevron (CVX) – Our position in Chevron was sold during the quarter. Chevron continues to offer a high-quality asset base, strong balance sheet, and attractive dividend profile. However, with the pending Hess acquisition and ongoing arbitration process creating some uncertainty around timing and integration, we saw an opportunity to rotate into ConocoPhillips. While the transaction is strategically sound, expected free cash flow contributions are more weighted toward the back half of the decade. We initiated a position in ConocoPhillips, which offers similar upstream exposure, a clearer near-term cash flow inflection, and trades at a meaningfully lower valuation.

Market Outlook:

The economic outlook improved over the second quarter as the policy-related uncertainty, which had weighed on sentiment, began to ease. While “soft” economic data – such as consumer sentiment, PMIs, and business confidence – declined sharply in response to tariff developments, “hard” data, including GDP, employment, and retail sales remained resilient though began to show signs of weakening late in the quarter. Credit conditions stayed supportive, and although year-over-year S&P 500 earnings growth estimates fell from 11% from the start of the year to 7% by quarter-end, they have since stabilized.

Renewed optimism around the AI investment theme has driven markets higher, with the rebound in the Magnificent 7 pushing the group's valuation back to record highs and market concentration to extreme levels. The trillions of dollars being invested into agentic AI will eventually need to be monetized. Capital expenditures among the top four hyperscalers – Meta, Google, Amazon, and Microsoft – have surged in recent years as these companies race to establish leadership in generative AI. This aggressive spending has contributed to a notable slowdown in both free cash flow and earnings growth, raising questions about the sustainability of their previously superior growth profiles. Free cash flow growth for the Magnificent 7 excluding NVDA has declined 11% year-over-year (Figure 4).

Figure 4: Magnificent 7 Y/Y FCF Growth (excluding NVDA)

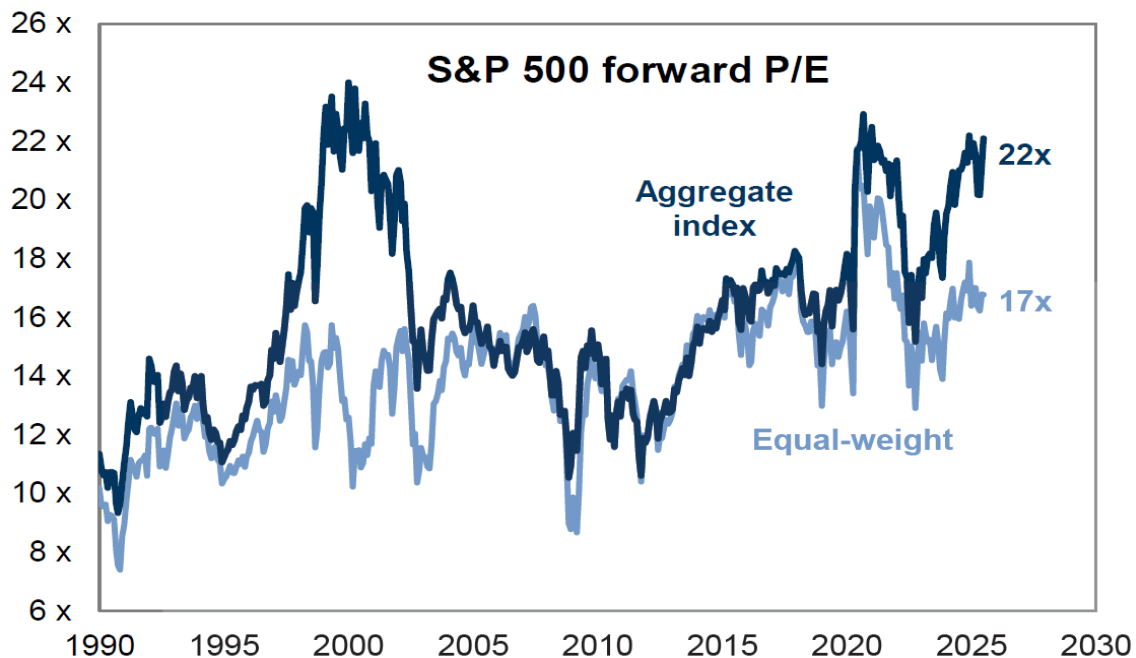


Source: Strategas Research, 05/28/2025. Data as of 03/31/2025.

The rally in the Magnificent 7 pushed market concentration to new extremes, with the top 10 stocks in the S&P 500 now comprising a record-high 38% of the index – a level not seen in over five decades. While market breadth has improved relative to the past two years - when only 29% of S&P 500 constituents outperformed the index, marking record lows – this year, 45% have outperformed. However, breadth narrowed again in the second quarter, with S&P 500 breadth falling to more than one standard deviation below its historical average.

Market valuations have returned to extremely elevated levels, with broad-based valuation metrics now sitting at multi-decade highs. The forward price-to-earnings (P/E) multiple of the capitalization-weighted S&P 500 now stands at 22x – its third-highest valuation level in over thirty years – marking a significant divergence from the equal-weighted S&P 500, which trades at a more modest 17x (Figure 5).

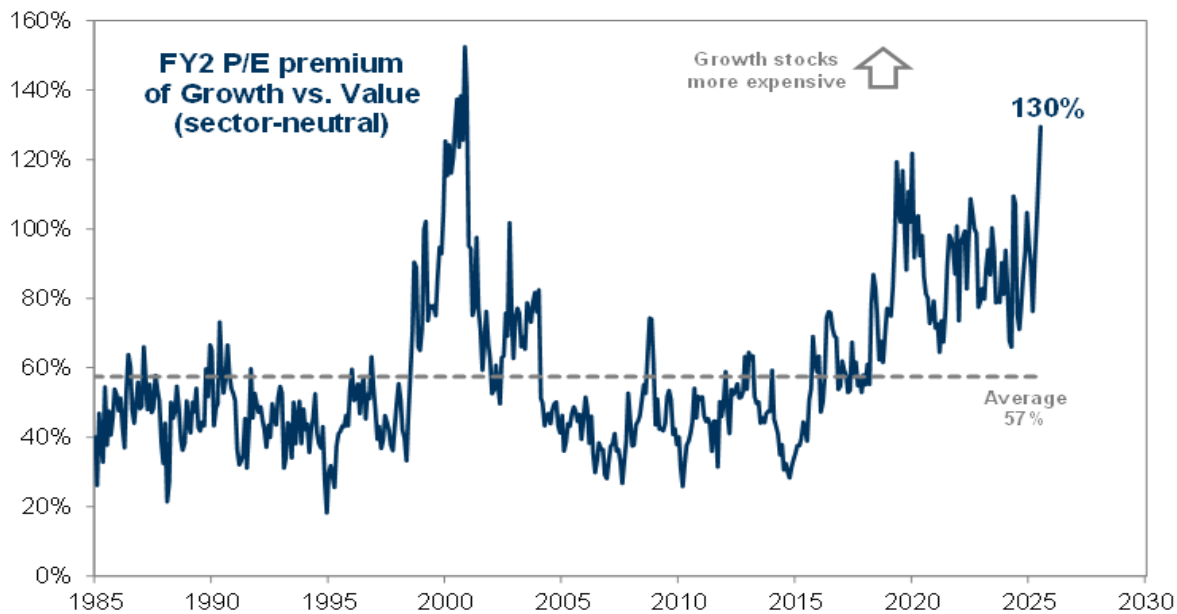
Figure 5: US Equity Index P/E Valuations vs. History



Source: Goldman Sachs, US Weekly Kickstart, 06/27/2025.

The valuation gap between Growth and Value stocks has reached historically extreme levels. Growth stocks currently trade at a 130% premium to Value stocks – more than double the long-term historical average of 57% and surpassing the peak seen during the speculative surge of 2020 (Figure 6).

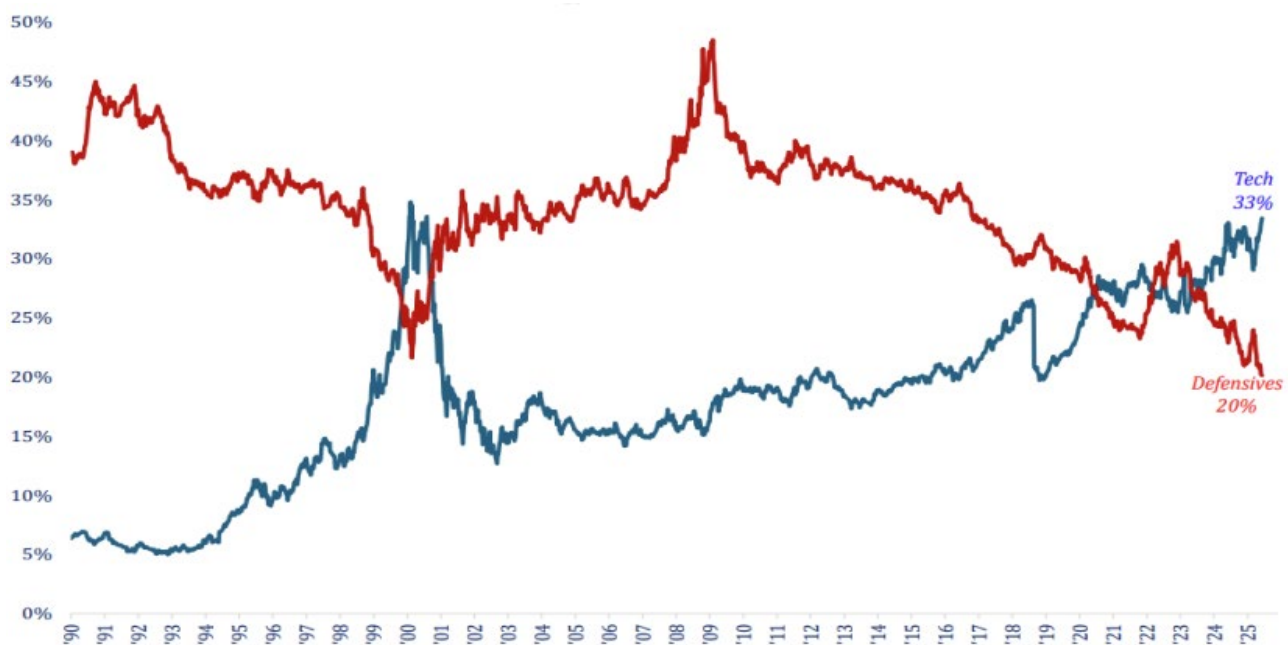
Figure 6: Valuation of Growth vs. Value Stocks



Source: Goldman Sachs Global Investment Research, 06/30/2025.
Growth and value stocks measured by Russell 1000 Value and Growth Indices.

Value and High Dividend stocks have underperformed over the past several years. Although they led in Q1, these factors were among the weakest performers in Q2. As a result, the combined weight of Defensive sectors in the S&P 500 – Consumer Staples, Energy, Healthcare and Utilities – fell to a multi-decade low at 20.8%, less than half their weight in 2009 (Figure 7). This shift has been largely driven by sector ETF flows, which have heavily favored Technology and, more recently, Cyclical sectors such as Financials and Industrials, at the expense of Defensives including Staples, Utilities, Real Estate, and Healthcare. Investor interest in dividend and defensive value strategies is now near record lows, which presents a compelling opportunity.

Figure 7: S&P 500 Sector % Weight – Technology vs. Defensive Sectors



Source: Strategas Research, ETF Research, 06/16/2025.

In summary, the extremely bullish sentiment toward Growth stocks – fueled by their strong outperformance in recent years – may face increasing headwinds from slowing earnings and cash flow growth. Coupled with historically wide valuation gaps relative to Value and Dividend stocks, these dynamics could serve as catalysts for a rotation into the latter. Positioning across retail, institutional, and systematic trading strategies remains heavily skewed towards Growth and, more recently, high-beta stocks, which were trading in the 100th percentile on a rolling 3-month basis at quarter-end. A more durable shift toward Value and Dividend stocks could be driven by factors such as a market or economic downturn, weaker-than-expected AI monetization or a broad market valuation contraction.

Thank you for your continued support. Feel free to reach out to us if you have any questions.

Best Regards,

Schafer Cullen Capital Management, Inc.

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