DISTILLATE CAPITAL

2025 Q1 Letter to Investors: Uncertainty

Letter Summary

Uncertainty is inherent to investing, but there are times like the present when it is more pronounced and investors' fears of the unknown grip markets. The current moment also involves not one but a confluence of several major issues with uncertain answers: how will tariffs impact the economy and corporate profitability; will much-hyped AI technology live up to expectations; what is the path and sustainability of government spending; what can, and should the Fed do facing potential slowing in the economy with inflation as an accelerated risk? Academia and Wall Street have trained investors to focus on risk more than uncertainty and to quantify it through mathematical formulas built around price volatility. But uncertainty differs from risk in that it is unknowable and cannot be easily mathematized nor modeled and investors who are more trained in these risk measures become very uncomfortable when confronted with uncertainty. Our investment processes are designed with this in mind and instead of emphasizing price volatility and risk metrics based on historic price patterns, employ a combination of measures around leverage, cash flow stability, and valuation with the goal of both navigating through uncertain times and capitalizing on the opportunities they create. Stability and not being burdened with excessive financial leverage offer clear benefits in an adverse or uncertain period, but so too does valuation – something easily underestimated. There are many parallels to both the macroeconomic and market backdrop of exactly 25 years ago but what many investors forget is that while the overall market struggled significantly in the years that followed, there was enormous divergence in price performance depending on starting valuation and size as is shown in **Figure 1**. As we again enter uncertain times with economic fragility and an exogenous shock, questions surrounding a new technology and massive investments behind it, and an expensive and concentrated market, we are optimistic that the combination of a valuation discipline and quality measures may again prove highly differentiating.

Performance Summary

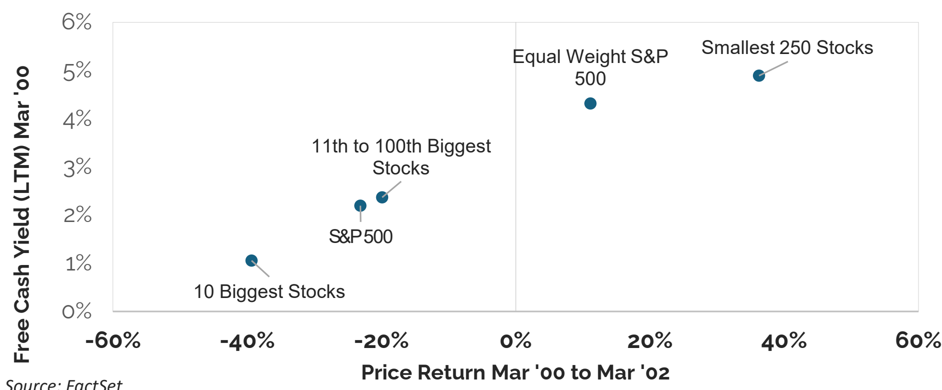
U.S. Fundamental Stability & Value (U.S. FSV): Amid a broader decline for the U.S. equities and a drop of -4.28% for the S&P 500, our U.S. FSV strategy outperformed by 3.3% with a more modest decline of -0.95% in the first quarter. The strategy lagged the Russell 1000 Value Index where the heavy energy, financial, and utility weights contributed to better performance. Annualized net of fee performance since inception remains solid at 0.9% ahead of the S&P 500 and 5.1% ahead of the Russell 1000 Value Index.

U.S. Small/Mid Cap Quality & Value (SMID QV): Our SMID QV strategy returned -9.30% in the first quarter on a total return basis. This outperformed the Russell 2000 Index by 0.18% and underperformed the Russell 2000 Value index by 1.55%. Annualized excess returns of our SMID QV strategy since inception and net of fees are 6.0% and 5.8% ahead of those benchmarks, respectively.

International Fundamental Stability & Value (Intl. FSV): Amid a general outperformance of international stocks in the quarter, our International FSV strategy's total return of 8.39% after fees exceeded the MSCI All Country Ex US ETF benchmark's gain of 6.20%. Annualized net of fee performance since inception is ahead of the benchmark by 0.14%.

U.S. Large Cap Value Long 130%/Short 30% (U.S. Value 130/30): Our 130/30 strategy returned 0.78% net of fees in the first quarter of 2025 vs. the S&P 500 Index's return of -4.28%. This strategy is 3.4% ahead of the S&P 500 ETF on an annualized net of fee basis and above the Russell 1000 Value Index by 7.5% since inception.

Figure 1: March 2000 Trailing Free Cash Yield & Subsequent 2Yr Return for S&P500 and Key Subgroups



Source: FactSet

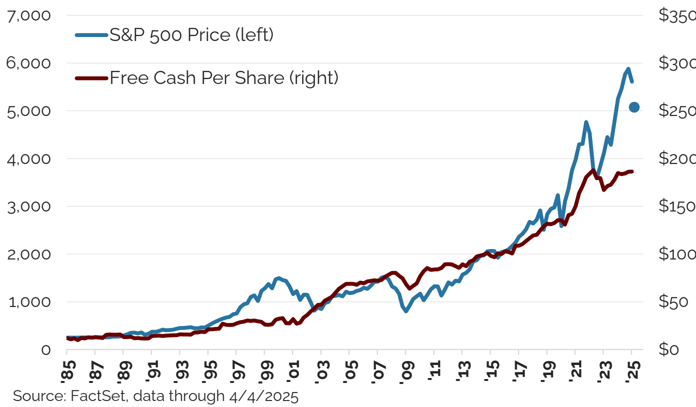
Past performance does not guarantee future results. One cannot invest directly in an index.

Market Commentary:

After rising sharply in each of the prior two years and running well ahead of underlying free cash flows (See **Figure 2**), U.S. equities declined in the first quarter and fell sharply in the first few days of the second quarter following announced tariffs. The post quarter move through April 4th is shown by the blue dot in the chart below. Even after these declines, however, the market is still somewhat extended above underlying free cash flows and remains expensive in a historical context.

Price increases for the S&P 500 continue to exceed free cash flow gains.

Figure 2: S&P 500 Free Cash Flow vs. Price



Source: FactSet, data through 4/4/2025

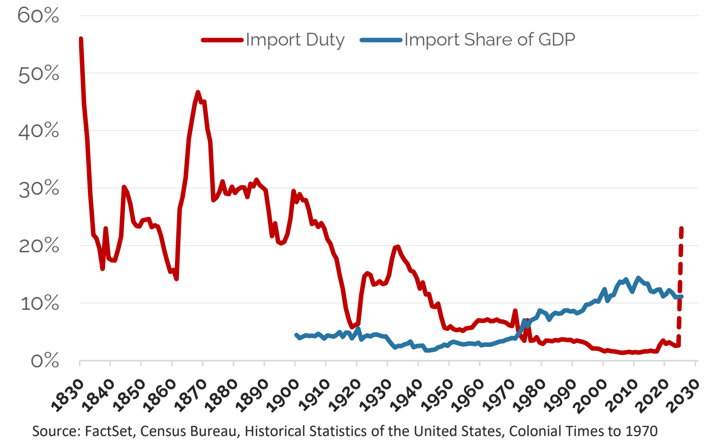
While tariffs are the major issue causing recent market declines, we see three main issues contributing to heightened levels of uncertainty and market weakness. Tariffs and macroeconomic policies are the first, new revelations that have dampened enthusiasm around AI are second, and the trajectory and sustainability of government spending is the final category. We will examine each.

Tariffs and Macroeconomic Uncertainty

One of the major uncertainties facing the market and weighing on stocks is the impact of tariffs and related macroeconomic policies. While the threat of impending tariffs had been an overhang for equities to some degree in the first quarter, President Trump's announcement of significant and sweeping tariffs on foreign goods on April 2nd sent shock waves through global markets. The import duties announced then amount to an effective tariff of around 23%[1] (See **Figure 3** where the dashed red line represents the recently announced rate). This would mark a level not seen in a century and one that eclipses even the famous Smoot-Hawley tariffs that were made famous by the Great Depression. Additionally, the global economy is more integrated now than in the past and imports are much larger as a share of GDP, which is also highlighted in **Figure 3**.

Announced tariffs are substantial..

Figure 3: U.S. Import Duty & Import Share of GDP

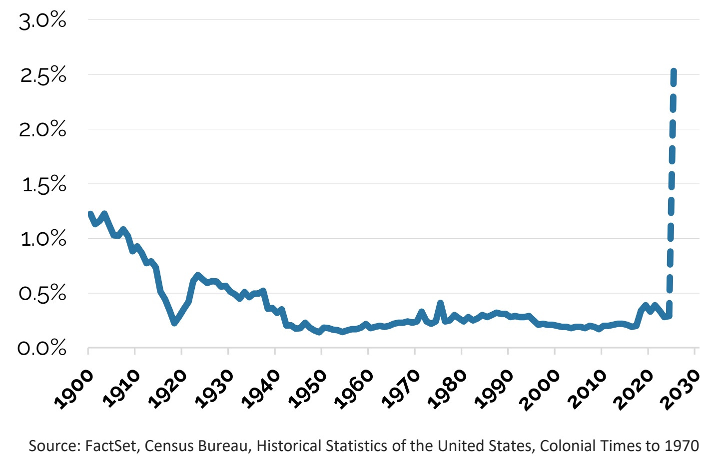


Source: FactSet, Census Bureau, Historical Statistics of the United States, Colonial Times to 1970

When the recently announced effective tariff rate is combined with the import share of GDP, the resulting combination of the potential tariff share of GDP is enormous. This is clear in **Figure 4** and highlights the scale of the potential shock from tariffs both in terms of inflation and the negative impact on economic activity. There are offsetting impacts to this simple combination, however, as some products will be substituted and some companies will not be able to pass through the costs to consumers and will absorb increased import costs through reduced profits. Those reduced profits, though, may lead to job losses and curtailed business investment which may result in broader economic weakness. On the other hand, some domestic producers may be able to raise prices to levels commensurate to the imported cost of competing goods and may see their profits increase while also stoking price pressures on domestic goods. Others may increase investment domestically to shore up production at home over time, but this also is highly uncertain.

The potential tariff impact on GDP is enormous.

Figure 4: U.S. Tariffs as a Share of GDP



Source: FactSet, Census Bureau, Historical Statistics of the United States, Colonial Times to 1970

1 https://www.bloomberg.com/news/newsletters/2025-04-03/tariffs-rip-through-global-markets-as-china-europe-vow-retribution

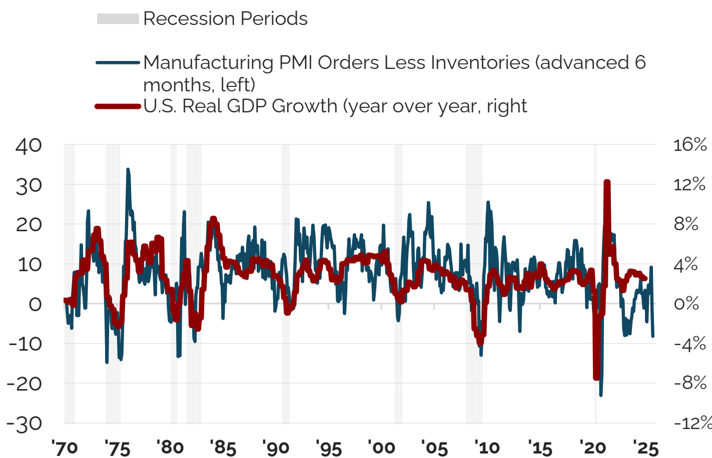
A great deal will also depend on how trading partners respond. Another concern is the likelihood that companies will spend several years trying to recoup increased import costs through higher prices. This occurred during the supply chain induced inflation in the pandemic and was highly problematic. In turn there is the risk that an inflation shock from imports could seep into heightened inflation expectations if prices are seen rising for a more prolonged time and this could risk more general inflationary pressures that are difficult to combat. Adding to this already intricate complex mix is an unknown impact on consumption from potential wealth declines.

It is possible that tariffs could be reduced, either by way of negotiations or several brewing legal or legislative challenges. This is also uncertain and it is likely that the announcement itself has set wheels in motion that will result in a significant impact even if modifications are made. Overall, the macroeconomic shock introduced by tariffs is likely to be very large and inflationary, but the full consequences are extremely uncertain.

Another unfortunate aspect of the tariffs is that they are coming exactly at a moment when the economy was already softening along several dimensions. The Manufacturing Purchasing Managers Index is a monthly survey that has historically provided a good measure of economic activity when the inventories component is subtracted from the orders component. Even before the tariff announcement, this measure, which leads GDP by 6 months in the chart (See **Figure 5**), was slowing sharply and pointing to a weaker overall economy.

Economic activity in the U.S. was slowing even before announced tariffs.

Figure 5: U.S. Manufacturing PMI Orders Less Inventories Leading Real GDP by 6 Months

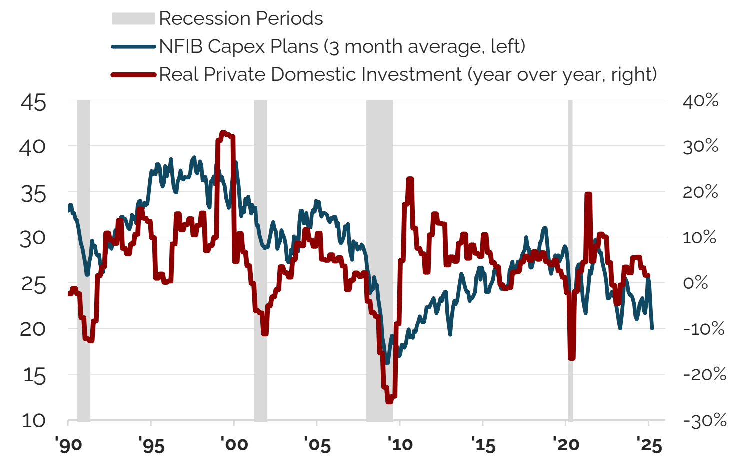


Source: FactSet, Bureau of Economic Analysis, Institute for Supply

Consistent with the broader economic slowdown indicated by the PMI survey, the National Federation of Independent Business survey of planned capital expenditures in the next three months was likewise signaling a slowdown in business investment (See **Figure 6**).

Measures of investment spending are also moderating.

Figure 6: U.S. NFIB Capex Plans vs. Investment Spending

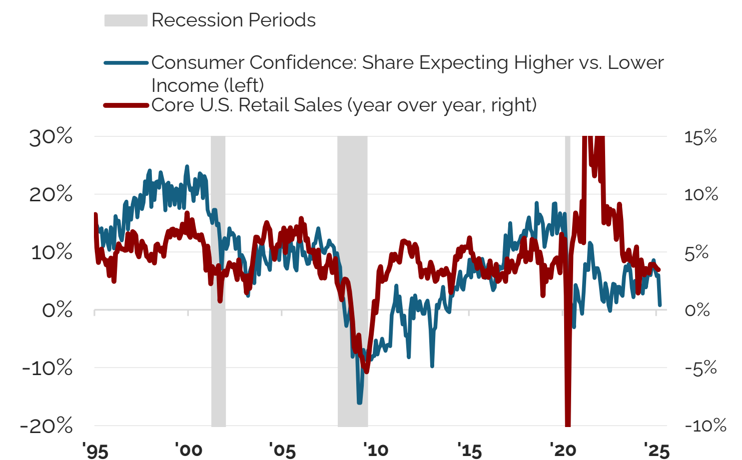


Source: FactSet, Bureau of Economic Analysis, National Federation of Independent

Measures of consumer health were also moderating. The share of consumers expecting higher versus lower incomes in six months has tracked core retail sales closely and was pointing to softer spending (See **Figure 7**).

Consumer spending looks poised to slow.

Figure 7: Consumer Income Expectations vs. Retail Sales



Source: FactSet, U.S. Census Bureau, Conference Board

Lastly, while inflation had been moderating after being very elevated, it remains above targeted levels and both consumer and business surveys were pointing to an acceleration, though some of this was likely due to expectations for tariffs.

In combination, these various measures of economic activity point to an economy that was already exhibiting signs of fragility before the tariffs were announced, and one that may be less durable to the tariff shock. Consequently, this makes the impact of the tariff hike and its reverberations even more uncertain with significant risk to the downside. The scale of the announced tariffs also puts us very much into uncharted territory and so it is extremely difficult to anticipate their full impact and all the complex follow-on impacts. The resulting uncertainty is therefore unlikely to dissipate soon and may remain an overhang investors must grapple with for some time.

AI Uncertainty

A second major uncertainty impacting equities is whether AI technology will deliver and ultimately generate profits on a level to justify the enormous investments being made. It is perhaps especially critical given the prices being given the stocks of those companies in the center of the boom and the degree to which they have provided stock market leadership. Should the bullishness turn out to be correct, there are questions about how those rewards will be distributed and which companies will see the greatest benefits. The prevailing wisdom had been that AI was an extremely capital-intensive endeavor and that only hyperscalers like Amazon, Microsoft, Meta, Oracle and a select few others could afford the enormous investment required to build AI data centers and these same companies were assumed to be the primary beneficiaries of the technology. It also followed that NVIDIA and other suppliers of the chips and equipment to build that computing capacity would be massive winners. Several recent developments, however, have challenged this prevailing view.

First, progress in AI is slowing even despite the enormous investments being made.[1] Additionally, issues like hallucinations, or the delivery of false or incorrect information, have been reduced but appear endemic to the technology, which may limit applications and ultimate demand.[2]

Second, Chinese company DeepSeek shocked the AI world with an AI model that cost a tiny fraction of what U.S. companies were spending. DeepSeek upended the thinking that capital intensity was a barrier to entry and that rewards would accrue to the largest incumbents. Microsoft and others countered this narrative with the idea that reduced costs will increase usage based on the example of increased coal demand from factories in industrial England that became more efficient users of coal. But this seems less applicable to AI demand today when much is already being offered for free and the revenue models are unclear.

Concerns about profitability are the third issue adding to uncertainty about the technology. While companies like OpenAI have been very successful in attracting users, revenues are still falling well short of costs[3] and OpenAI's key partner Microsoft, seems to be distancing itself from what was previously a very close partnership.[4]

Microsoft's recent pull back from data center investments is the next development that has added to uncertainty.[5] A former leader in the industry's expansion, a pullback may indicate that the company is worried about overcapacity. Adding to the angst, Eddie Wu, CEO of Alibaba, the Chinese technology company heavily involved in AI, recently voiced concerns about the level of spending in the U.S. and raised the prospect that it was a bubble.[6] This may be informed by the experience in China where large amounts of new data center capacity are reportedly going unused.[7]

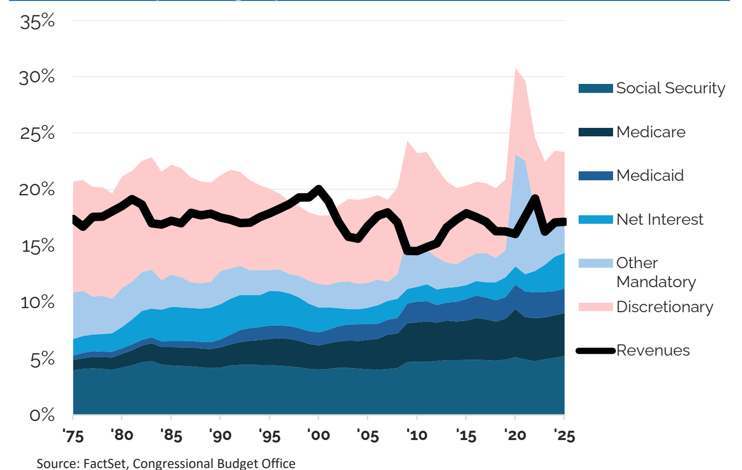
As with the impact of tariffs, issues around the profitability and future path of AI technology are complex and unknown. Where there was previously unreserved optimism and an assumption that incumbents would only further their dominance, there is now creeping uncertainty.

Government Spending Uncertainty

A final area of uncertainty is the path and sustainability of government spending. While the Federal Government ran significant budget deficits around the pandemic to provide countercyclical spending, it has continued to spend even as the economy returned to full health and low unemployment. In fiscal years 2023 and 2024, the federal deficit amounted to 6.2% and 6.4% of GDP, respectively. Concerningly, increased costs of mandatory spending on social security, Medicare, Medicaid, interest expense, and several other categories now absorb that full amount of revenues such that all discretionary spending is being done with borrowed dollars (See **Figure 8**.) The trajectory of spending is also likely to worsen as tax cuts that were planned to expire for budgetary reasons are likely to be extended. The deficit and debt will worsen as this occurs and there will be little stimulus provided relative to current conditions since an extension would only maintain the level of tax rates today. Ultimately, these levels of deficit spending and debt accumulation are unsustainable and will require spending cuts, increased taxes, or a combination of the two. Exactly how or when this issue may intensify is unknown, but it is yet another uncertainty that is increasingly weighing on investment decisions.

Mandatory spending now consumes the entirety of government tax revenues meaning all discretionary spending is deficit spending.

Figure 8: U.S. Federal Government Revenues vs. Expenses by Category as a Share of GDP



Source: FactSet, Congressional Budget Office

1 https://www.theinformation.com/articles/openai-shifts-strategy-as-rate-of-gpt-ai-improvements-slows?rc=wixrwf
2 https://www.nature.com/articles/d41586-025-00068-5
3 https://www.nytimes.com/2024/09/27/technology/openai-chatgpt-investors-funding.html
4 https://gizmodo.com/microsofts-relationship-with-openai-is-not-looking-good-2000573293
5 https://www.bloomberg.com/news/articles/2025-04-03/microsoft-pulls-back-on-data-centers-from-chicago-to-jakarta
6 https://www.bloomberg.com/news/articles/2025-03-25/alibaba-s-tsai-warns-of-a-bubble-in-ai-datacenter-buildout
7 https://www.technologyreview.com/2025/03/26/1113802/china-ai-data-centers-unused/

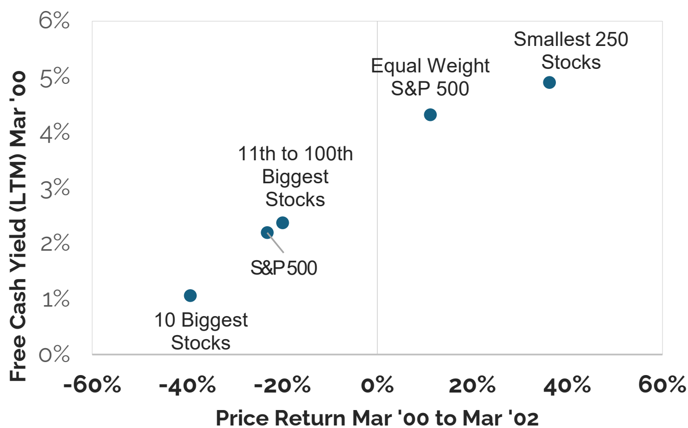
Uncertainty & Valuation in the Past

The quote is well worn, but fitting -- Mark Twain -- "history doesn't repeat itself, but it often rhymes". The parallels between today's economic and market backdrop and those of exactly 25 years ago are eerily similar. The late-1990's also experienced a combination of a slowing economy and an economic shock, coupled with dissipating enthusiasm and uncertainty relating to an exciting new technology that propelled equities to new highs and extremely rich valuations and levels of concentration. While there are a number of key differences between then and now and the scale of market's richness was higher then, there is much that looks alike. The gap between prices and fundamentals from **Figure 2** looks similar. Both were driven by the excitement around a new and potentially transformative technology that spurred massive investment in supportive infrastructure (fiber then and data centers now). The enormous gains that accrued to the companies selling equipment for that infrastructure (Lucent, Cisco and others then vs. NVDIA, Broadcom and others today) is also similar. An economic recession officially began in March of 2001 but was exacerbated by the economic shock from the September 11 terror attack. The economic shock today comes from tariffs but is also occurring at a time that growth was showing signs of slowing.

While considering these remarkable similarities, it is easy to remember the market downturn that followed without adequately considering its nuances. Crucially, most of the market richness, where stock prices had driven the overall free cash flow yield to 2.2%, was due to the very biggest stocks, as the 10 largest stocks were trading at an extremely rich 1.1% free cash flow yield. The next biggest 90 stocks were also expensive, but less so, while the smallest 250 stocks were dramatically less expensive. Those differences in valuation in March of 2000 had an enormous impact on subsequent returns as the biggest and most expensive stocks suffered the most. While those stocks were down significantly two years later, the cheapest stocks were higher in absolute terms (See **Figure 9**), and brought the equal weighted index into positive territory as well.

After March '00, there was an enormous divergence in equity performance associated with starting valuations.

Figure 9: S&P 500 Starting Free Cash (LTM) Valuation in March '00 vs. Subsequent Two Year Return

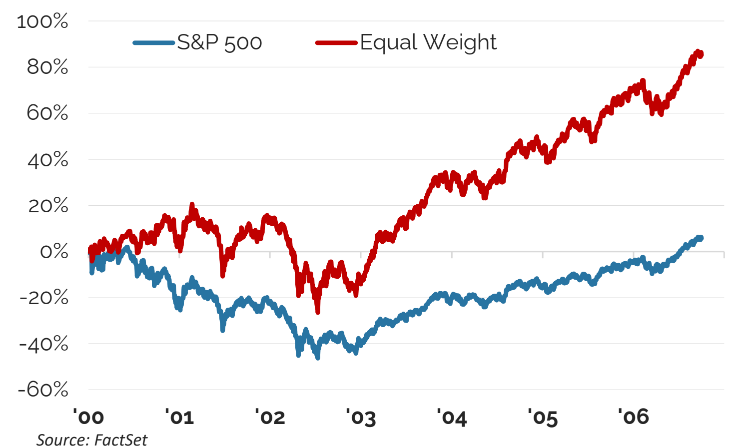


Source: FactSet

The divergence in returns between the largest and most expensive stocks and the rest of the market did not stop quickly. While it took the capitalization-weighted S&P 500 nearly seven years to return to its March of 2000 levels, an equal weighted version of the benchmark was up over 80% in that same period (See **Figure 10**). Indeed, there was significant opportunity to be had below the surface.

An equally-weighted index substantially outperformed the market-cap weighted index post-March '00.

Figure 10: S&P 500 vs. Equal Weight Post March '00



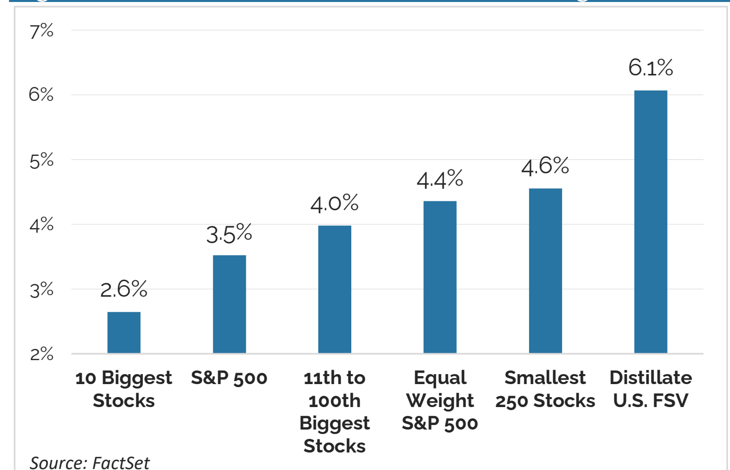
Source: FactSet

Today, the market dynamic around valuation and concentration closely resembles conditions 25 years ago. **Figure 11** shows a remarkably similar valuation composition where today's largest stocks are trading more expensively than their smaller peers and the market averages. The chart includes our U.S. FSV strategy which is less expensive than either the equal weight or small stock group.

Back to Twain's quote, we are optimistic that there may be good returns to be had today despite challenges just as there were in 2000. We also believe that it is extremely important that our strategy is achieving this valuation spread while filtering out stocks that have high leverage and unstable cash flow profiles, significantly differentiating it from the equal weighted index and the group of smaller stocks within the S&P 500.

Today's valuations, by size, resemble the pattern of March '00.

Figure 11: Free Cash Yields March '25 (trailing)



Source: FactSet

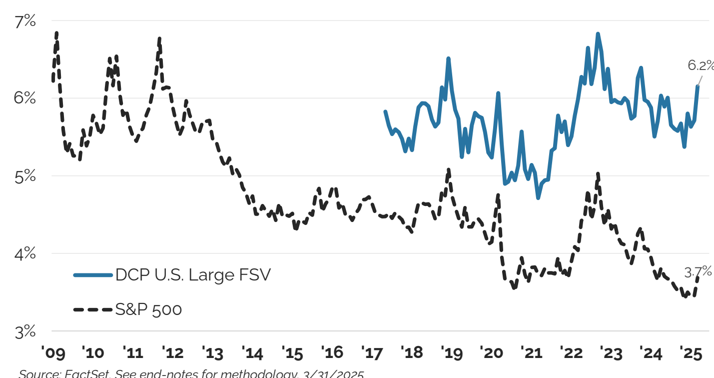
U.S. Large Cap

The richness of the largest names in the market and the enormous resulting valuation dispersion has enabled our U.S. FSV strategy to achieve a record valuation spread over the S&P 500. While the S&P 500 has seen its free cash flow to enterprise value yield decline from around 4.5% to 3.7% in the seven years since we launched our strategy, the comparable metric for our U.S. FSV strategy has actually risen and ended the quarter at 6.2% (See **Figure 12**). Notably, our strategy has outperformed the S&P 500 over this period despite its valuation becoming more attractive while the S&P 500 got much more expensive. At present, our free cash yield advantage is the highest it has ever been and the absolute free cash flow yield is at the same level as was the overall market during the depths of the crisis in 2009, an entry point for equities which in retrospect turned out to be very fortuitous.

We would also note that estimated free cash flows underpinning these valuation metrics are likely to change, as they are for the entire market, and so there is likely to be some movement in these valuation figures. By focusing on companies with more stable historical and estimated cash flows per share, however, the intention is that estimate revisions will be more stable for the stocks in our portfolio than they will be for the overall market. Companies that see significant deterioration in their normalized multi-year estimates or that see significant erosion in the stability of their cash flows will be sold from the portfolio as they would no longer meet the required criteria for inclusion and would not be considered among the names best equipped to weather turbulent times. We would also expect the portfolio to rebalance into newly cheap names that have low debt and good fundamental stability but that were sold off off indiscriminately amid a broader period of panicked conditions. In this sense, in periods of volatility, the portfolio design both seeks to capitalize in the down market period by protecting capital, but also the eventual recovery by rotating into higher quality names that become newly cheap.

The NTM free cash to EV yield for Distillate's U.S. FSV has risen from when the strategy began while the S&P 500's has fallen sharply with the result that the valuation differential is at a record high.

Figure 12: Free Cash to Enterprise Value Yield for Distillate's U.S. FSV Strategy vs. the S&P 500

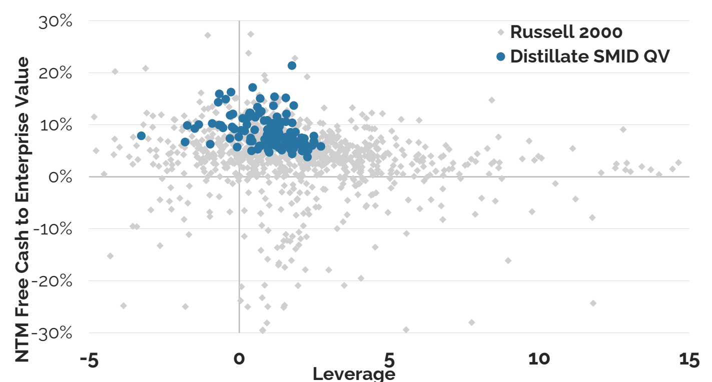


Small/Mid

We see much the same polarity in the opportunity set in the small and mid-cap space. As we have suggested in prior letters, the broader small stock indexes do not look that attractive in aggregate when properly assessed. There are two key reasons for this. First, the small stock indexes include a large portion of unprofitable companies that are dragging down the valuation of the overall group. Second, small companies have very high debt loads at present and this too is weighing on valuation when leverage is considered. Fortunately, there is enormous dispersion in the small cap space that allows us to navigate both issues. **Figure 13** highlights our positioning across the valuation and leverage metrics while also showing the enormous range among the index's constituents. Given the uncertainty facing the economy and market and potential headwinds, large debt burdens and a lack of profitability look to be an especially dangerous and combustible mix. While we worry that many small/mid stocks could struggle mightily, we do see significant opportunity for differentiation.

Distillate's Small/Mid QV's holdings have both low leverage and high free cash yields while the rest of the small cap market is highly scattered.

Figure 13: FCF/EV Yield vs. Leverage by Stock

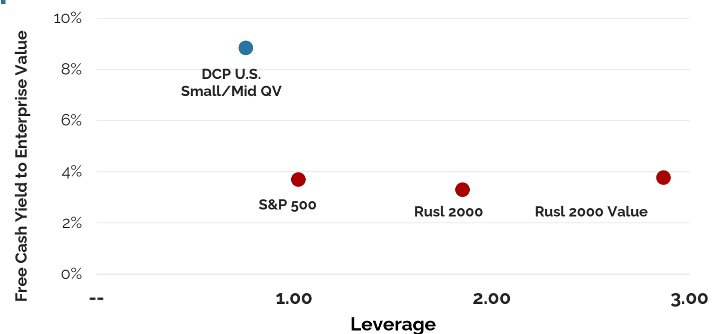


Source: FactSet, data as of 3/31/2025

When these holdings are aggregated at the portfolio level, our Small/Mid QV strategy has a substantially better valuation with much lower leverage than the small cap or large cap benchmarks (see **Figure 14**).

Small stocks in aggregate do not look especially attractive vs. large stocks when leverage and negative earning stocks are included, but Distillate's Smid QV strategy does.

Figure 14: FCF/EV Yield vs. Leverage by Portfolio



Source: FactSet, See end-notes for methodology. As of 3/31/2025

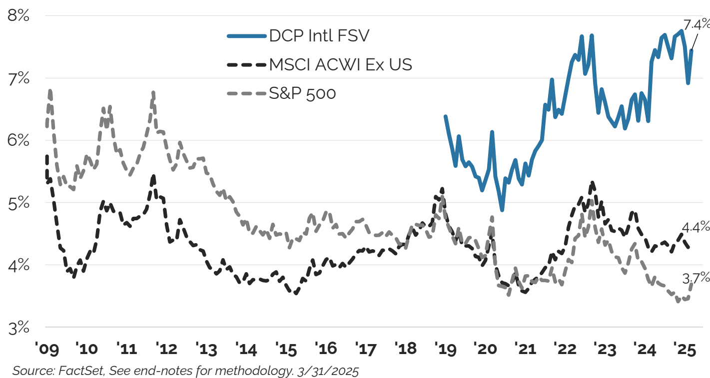
International

After a long stretch of underperformance, international stocks outperformed their domestic counterparts in the first quarter. Fifteen years ago, international stocks were more expensive than U.S. stocks measured using free cash flow. They also had more debt, a legacy of less stable cash flow generation, and faced slower growth. In combination, this made the U.S. market look like the clear winner from an investing perspective despite much commentary to the opposite and investor enthusiasm for foreign securities. Now, after a long period of underperformance, international stocks are finally less expensive than their U.S. counterparts and look appealing on a relative valuation basis.

The history of overall U.S. and international valuations as well as that of our own strategy are shown in **Figure 15**. International stocks do still have more debt and less stable cash flow profiles, but again those risk can be reduced by filtering out highly levered or fundamentally less stable stocks as our investment process does. Recognizing we risk being the proverbial broken record, we believe being selective is critical in improving the probability of success over the long term by gravitating to those stocks that are the least expensive that meet our quality criteria.

Distillate's Intl. FSV's FCF/EV yield is well above that of key benchmarks.

Figure 15: Free Cash to EV vs. Leverage for Distillate's Intl Strategy vs. Various Benchmarks



Source: FactSet, See end-notes for methodology. 3/31/2025

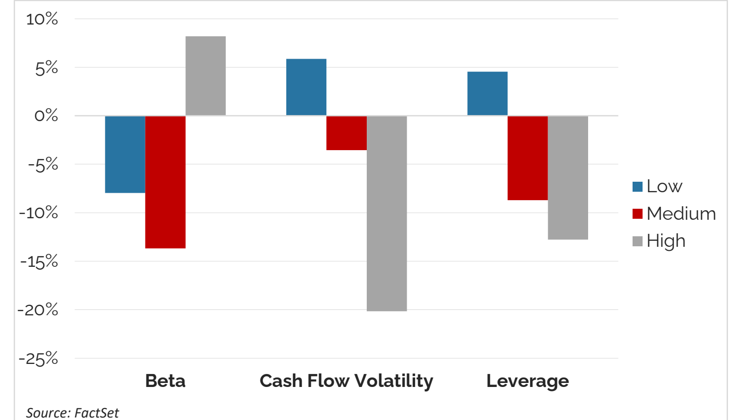
Final Word

Markets abhor uncertainty, yet it is at the very core of investing. Wall street and academia are largely focused on measures of risk that are based on prior price moves and much less equipped to sit with the discomfort of uncertainty where probabilities are unknown. Worse, investors may become lulled into false confidence that risk measures provide them security, and then react rashly and sub-optimally when suddenly confronted with uncertainty and unexpected poor results. It is precisely this view that shaped our strategy's design. We do not use short-term measures of risk utilizing stock price volatility that are prone to changing dramatically at exactly the moment you would ideally have them the most stable. Instead, we focus on more durable measures of quality and include valuation as a key component of the design that puts protecting capital in difficult times as our highest priority.

As noted earlier in this letter, valuation proved its efficacy in 2000 when the backdrop looked remarkably similar in many ways. Leverage and stability proved their value more recently in the highly challenging early months of the pandemic when conditions were extremely uncertain. In the first half of 2020, beta did a poor job of protecting capital with low beta names and strategies performing poorly and high beta stocks actually doing the best. By contrast, our measures of leverage and stability acted as we would have hoped, with the least indebted names and least fundamentally volatile stocks outperforming.

Traditional risk metrics like beta struggled in the pandemic while our measures of cash stability and leverage performed well.

Figure 16: Performance by Beta vs. Distillate's Measures of Quality in the Pandemic (H1 2020)



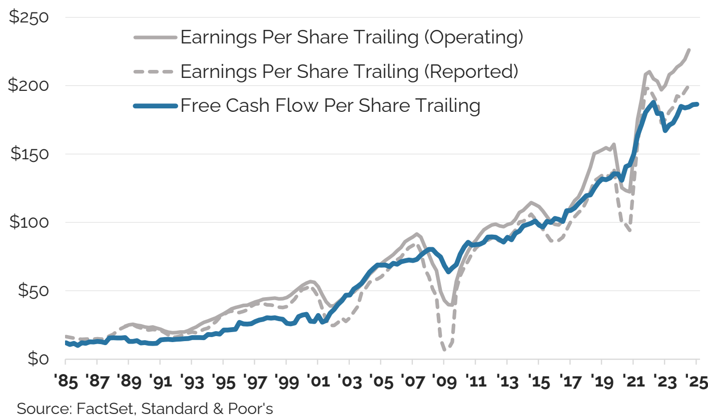
Source: FactSet

In periods of economic distress, we also think it is an important point of differentiation to be focusing on free cash flow per share rather than measures of earnings. We have written at length about why we believe free cash flows are a better valuation measure in an increasingly asset light economy, but one additional reason is that free cash flows tend to be more stable themselves as they are less subject to write downs and other accounting treatments that can make earnings-based measures highly volatile. This is also why Warren Buffett called net income "worse than useless." The volatility of net income measures relative to free cash flows is seen in **Figure 17**. The

chart shows both reported earnings based on GAAP accounting principals and operating earnings which are self-reported by the companies and unsurprisingly include highly favorable adjustments. In addition to the other reasons we prefer to use free cash flow, we believe its relative stability and lack of distortion from accounting issues is particularly important during challenging economic periods when net income figures are highly volatile and more likely to lead investors to mistakes in assessing valuation opportunities.

Distillate's Intl. FSV's FCF/EV yield is well above that of key benchmarks.

Figure 17: Trailing S&P 500 Earnings Per Share (Operating & Reported) vs. Free Cash Flow



Source: FactSet, Standard & Poor's

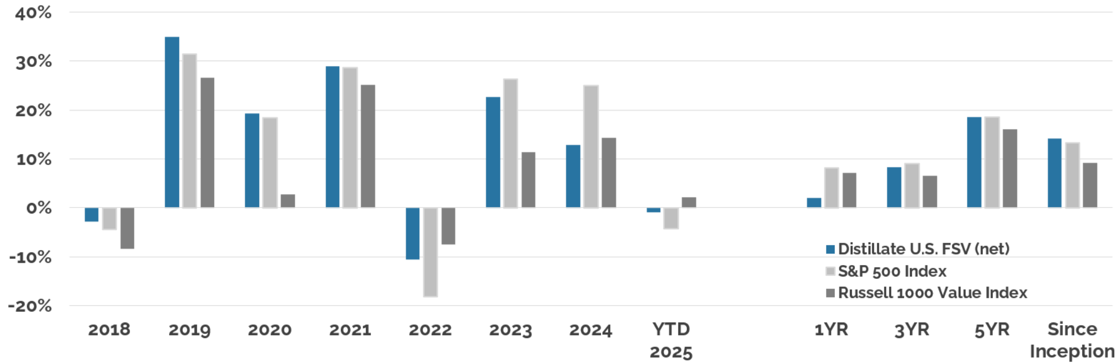
We do not know what the coming period will bring. But we don't think anyone else does either. We are very much in uncertain times and much could change at any minute. Still, despite the potential challenges, the past may provide some guide given the remarkable similarities to the period 25 years ago. The lesson from that time was that the less expensive subsegments of the market can do quite well even if the overall market struggles amid uncertainty and a variety of headwinds. We also believe that focusing on the durability of cash flows and low debt levels are critical amid uncertain and challenging times. Like in car racing, victories come out of performance in the turns, not the straightaways, and we believe navigating the turns with free cash flow is the much better path.

Performance & Rebalance Appendix

U.S. Fundamental Stability & Value Composite Performance:

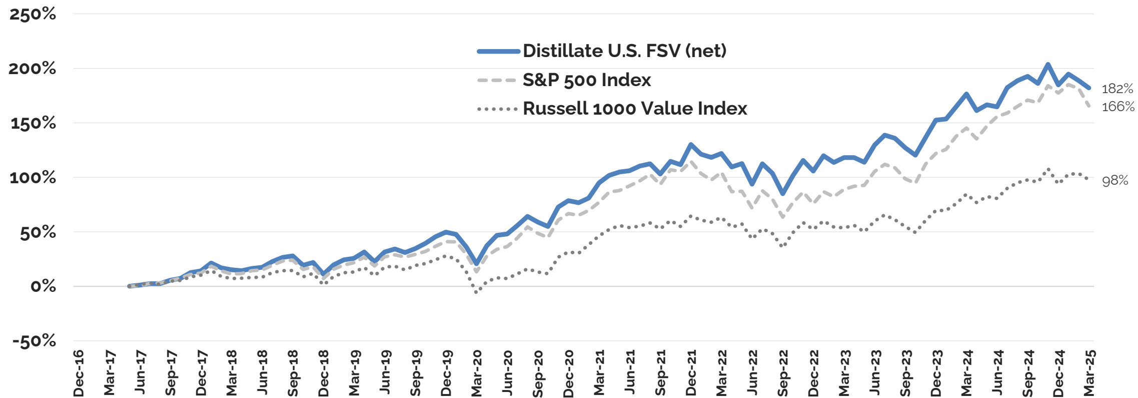
As of March 31, 2025

	2017*	2018	2019	2020	2021	2022	2023	2024	YTD 2025	1YR	3YR	5YR	Since Inception
Distillate U.S. FSV (net)	14.18%	-2.79%	34.91%	19.22%	28.91%	-10.58%	22.67%	12.84%	-0.95%	2.01%	8.34%	18.51%	14.16%
S&P 500 Index	12.11%	-4.39%	31.47%	18.39%	28.68%	-18.13%	26.26%	25.00%	-4.28%	8.23%	9.04%	18.57%	13.28%
Russell 1000 Value Index	10.27%	-8.41%	26.52%	2.78%	25.12%	-7.56%	11.41%	14.35%	2.13%	7.16%	6.61%	16.12%	9.11%



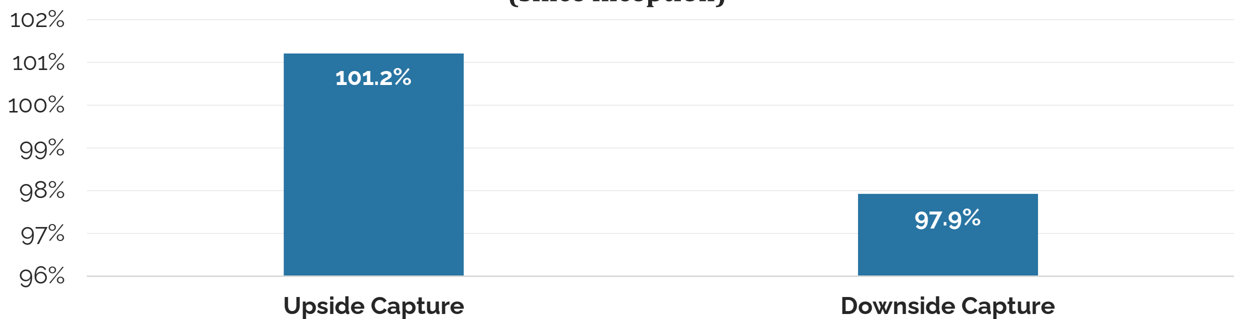
Source: U.S. Bank, Morningstar Data; Inception 5/31/2017; the period "2017*" reflects returns from inception through 12/31/2017. One cannot invest directly in an index. See performance disclosures.

Cumulative Return (Inception through 3/31/25)



Source: U.S. Bank, Morningstar Data; Inception 5/31/2017. One cannot invest directly in an index. See performance disclosures.

Distillate U.S. FSV Strategy: Upside & Downside Capture vs. S&P 500 Index (since inception)



Source: Zephyr Analytics, see definition

Past performance does not guarantee future results. See disclosures. Upside Capture reflects the relative compounded annualized return of a strategy compared to that of the benchmark in periods (months) when the benchmark rose in value; Downside Capture is the same but for periods when the benchmark fell in value. One cannot invest directly in an index.

Top Contributors and Detractors From Relative Performance:

U.S. FSV Strategy: Owned Stocks 2025 YTD Impact to Relative Returns (vs. S&P 500)

Top Contributors	Impact	Largest Detractors	Impact
T-MOBILE US INC	0.40%	ON SEMICONDUCTOR	-0.28%
ABBVIE INC	0.35%	PAYPAL HOLDINGS	-0.24%
THE CIGNA GROUP	0.27%	VIATRIS INC	-0.22%
JOHNSON&JOHNSON	0.26%	EPAM SYSTEMS INC	-0.19%
ELEVANCE HEALTH	0.22%	NETAPP INC	-0.17%

Rebalance Summary:

U.S. FSV Strategy: Portfolio Changes During Recent Quarterly Rebalancing

Largest Purchases	Weight	Largest Sales	Weight	Largest Sector Changes
Merck & Co., Inc.	2.8%	CME Group Inc. Class A	-1.1%	Energy (+2.8%)
Marathon Petroleum Corp	1.3%	Southern Copper Corporation	-1.1%	Consumer Staples (-1.9%)
Vistra Corp.	1.0%	VeriSign, Inc.	-0.9%	Financials (-1.7%)

Largest Adds	Weight	Previous	Largest Trims	Weight	Previous
ON Semiconductor Corp	0.9%	0.6%	T-Mobile US, Inc.	2.0%	2.7%
PayPal Holdings, Inc.	1.2%	1.0%	AbbVie, Inc.	2.6%	3.2%
EPAM Systems, Inc.	0.8%	0.5%	Johnson & Johnson	2.3%	2.9%

Rebalance Calculation Date: 3/21/2025

U.S. FSV Portfolio Characteristics*

	U.S. FSV	S&P 500	Russell 1000 Val ETF
Free Cash Yield to Mkt Cap[1]	7.1%	4.1%	5.0%
Free Cash Yield to EV[1]	6.2%	3.7%	4.1%
P/E[2]	14.2	20.2	16.4
Leverage[3]	1.1	1.0	2.0
Cash Flow Stability[4]	0.84	0.70	0.57
Dividend Yield	1.8%	1.4%	2.2%

*as of 3/31/2025, see methodology endnotes.

U.S. FSV Portfolio Sector Weights

	U.S. FSV	S&P 500
Communication Services	5.7%	9.2%
Ex GOOGL & META	5.7%	3.1%
Consumer Discretionary	12.5%	10.3%
Ex AMZN & TSLA	12.5%	5.0%
Consumer Staples	6.9%	6.1%
Energy	7.3%	3.7%
Financials	5.1%	14.7%
Ex Banks	5.1%	10.3%
Health Care	24.3%	11.2%
Industrials	15.7%	8.5%
Information Technology	16.3%	29.6%
Ex MSFT, AAPL & NVDA	16.3%	11.2%
Materials	5.3%	2.0%
Real Estate	0.0%	2.3%
Utilities	0.9%	2.5%

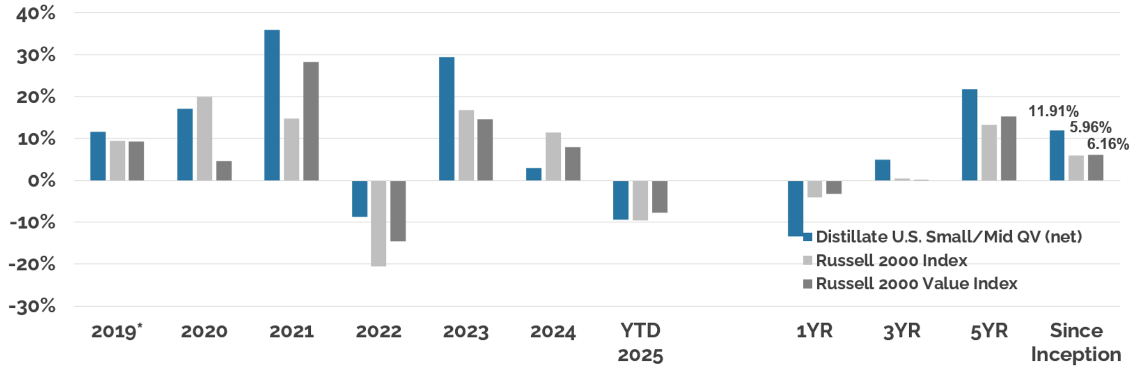
*as of 3/31/2025

Past performance does not guarantee future results. Top contributors and detractors are calculated gross of fees and use end of day pricing, which might differ from actual transactions. The top contributors and top detractors represent extracted performance. Strategy level net performance is available on the previous page and upon request. For the Rebalance Summary, position weights and changes are as of the portfolio reconstitution calculation date and data may vary slightly compared to actual implementation based on price fluctuations. Statistical data is sourced from FactSet. Portfolio holdings may change at any time without notice.

U.S. Small/Mid Cap Quality & Value Composite Performance:

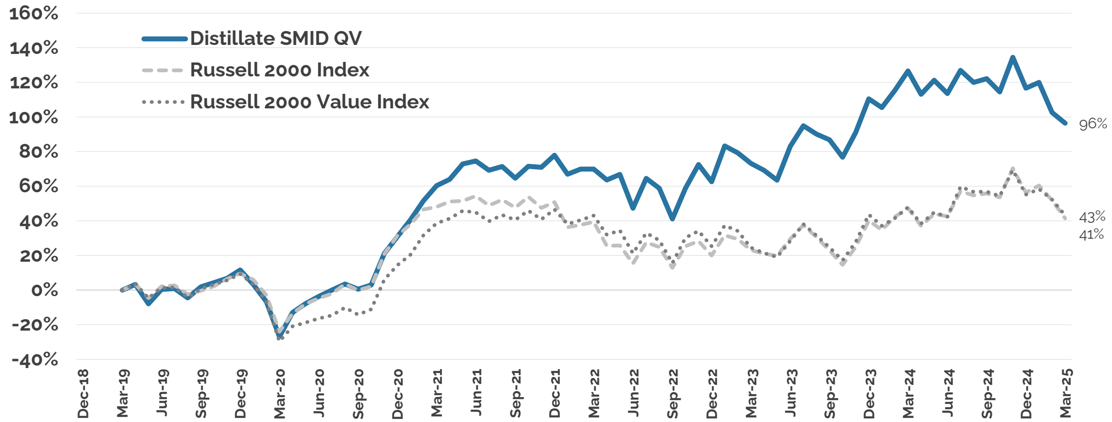
As of March 31, 2025

	2019*	2020	2021	2022	2023	2024	YTD 2025	1YR	3YR	5YR	Since Inception
Distillate U.S. Small/Mid QV (net)	11.65%	17.15%	36.03%	-8.64%	29.46%	2.92%	-9.30%	-13.31%	4.95%	21.84%	11.91%
Russell 2000 Index	9.53%	19.93%	14.78%	-20.46%	16.88%	11.52%	-9.48%	-4.02%	0.49%	13.24%	5.96%
Russell 2000 Value Index	9.33%	4.60%	28.21%	-14.50%	14.58%	8.03%	-7.74%	-3.14%	0.01%	15.27%	6.16%



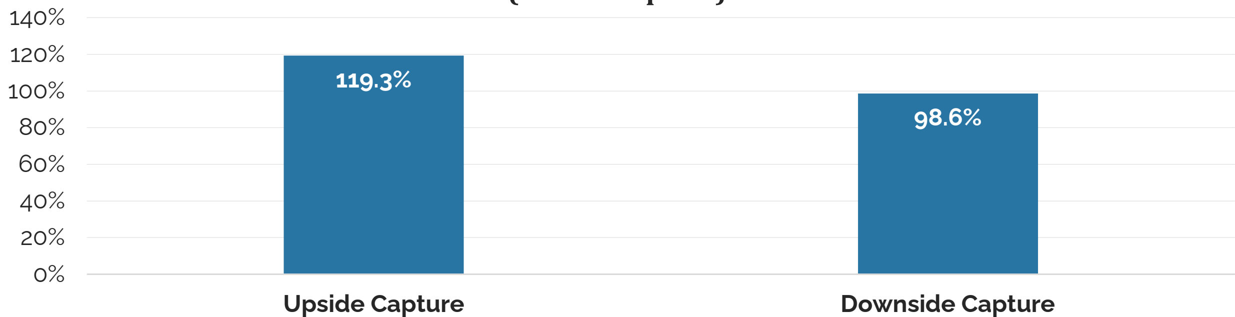
Source: U.S. Bank, Morningstar Data; Inception 3/31/2019; the period "2019*" reflects returns from inception through 12/31/2019. One cannot invest directly in an index. See performance disclosures.

Cumulative Return (Inception through 3/31/25)



Source: U.S. Bank, Morningstar Data; Inception 3/31/2019. One cannot invest directly in an index. See performance disclosures.

Distillate SMID QV: Upside & Downside Capture vs. Russell 2000 Index (since inception)



Source: Zephyr Analytics, see definition

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Top Contributors and Detractors From Relative Performance:

U.S. SMID QV: Owned Stocks 2025 YTD Impact to Relative Returns (vs. Russell 2000)

Top Contributors	Impact	Largest Detractors	Impact
TAPESTRY INC	0.35%	CORE NATURAL RES	-0.47%
HUNTINGTON INGAL	0.25%	PVH CORP	-0.33%
OPTION CARE HEAL	0.18%	VICTORIA'S SECRE	-0.31%
CAVCO INDUSTRIES	0.18%	ALPHA METALLURGI	-0.28%
CONCENTRIX CORP	0.15%	DILLARDS INC-A	-0.27%

Rebalance Summary:

U.S. SMID QV Strategy: Portfolio Changes During Recent Quarterly Rebalancing

Largest Purchases	Weight		Largest Sales	Weight	
Huntington Ingalls Industries	1.5%		Tapestry, Inc.	-2.2%	
TopBuild Corp.	1.5%		Cavco Industries, Inc.	-1.7%	
United Therapeutics Corp	1.5%		Grand Canyon Education, Inc.	-1.1%	
Largest Adds	**Weight**	**Previous**	**Largest Trims**	**Weight**	**Previous**
Toll Brothers, Inc.	1.5%	1.2%	Core Natural Resources, Inc.	0.7%	1.5%
Caleres, Inc.	0.5%	0.3%	Chord Energy Corporation	0.9%	1.6%
Owens Corning	1.5%	1.3%	C.H. Robinson Worldwide	1.1%	1.4%
Rebalance Calculation Date:	**2/27/2025**				

U.S. SMID QV Portfolio Characteristics*

	SMID QV	Russell 2000	Russell 2000 Value
Free Cash Yield to Mkt Cap[1]	11.0%	4.7%	5.8%
Free Cash Yield to EV[1]	8.8%	3.3%	3.8%
P/E[2]	9.9	14.0	11.8
Leverage[3]	0.8	1.9	2.9
Fundamental Stability[4]	0.53	0.42	0.35
Negative FCF Weight[5]	0.0%	16.1%	16.6%

*as of 3/31/2025, see methodology endnotes.

U.S. SMID QV Portfolio Sector Weights

	SMID QV	Russell 2000	Russell 2000 Value
Communication Services	4.3%	2.6%	3.2%
Consumer Discretionary	26.2%	9.1%	9.0%
Consumer Staples	2.9%	3.2%	2.7%
Energy	14.4%	5.1%	6.3%
Financials	6.5%	19.8%	30.6%
Health Care	8.6%	16.7%	8.6%
Industrials	23.4%	17.6%	12.4%
Information Technology	8.5%	12.4%	5.9%
Materials	5.2%	3.9%	3.8%
Real Estate	0.0%	6.4%	11.3%
Utilities	0.0%	3.2%	6.2%
Not Classified	0.0%	0.0%	0.0%

*as of 3/31/2025

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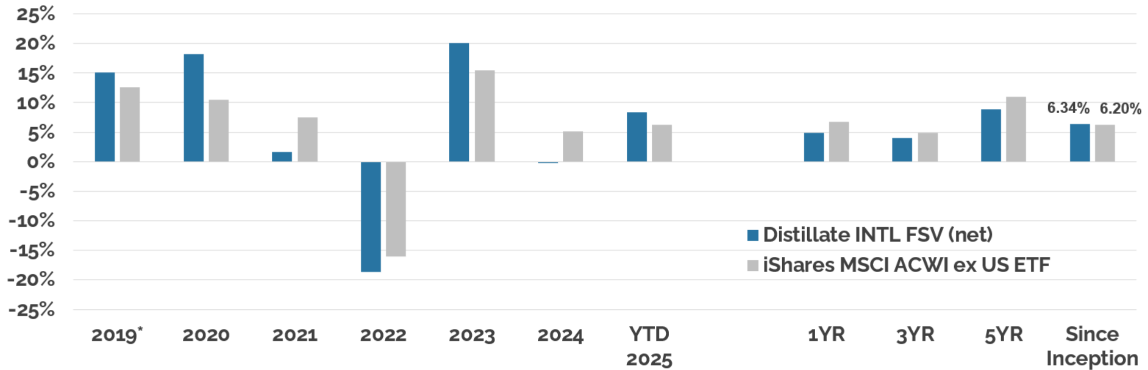
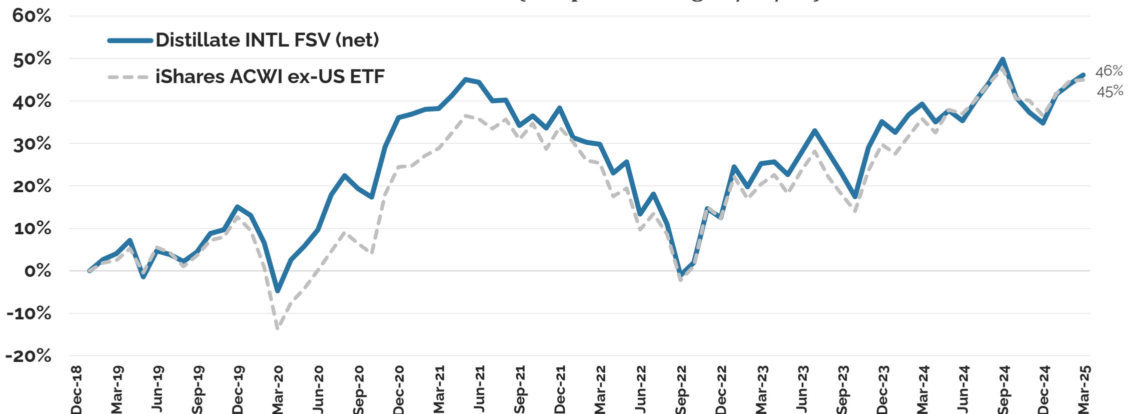
International Fundamental Stability & Value Composite Performance:

As of March 31, 2025

	2019*	2020	2021	2022	2023	2024	YTD 2025	1YR	3YR	5YR	Since Inception
Distillate INTL FSV (net)	15.08%	18.26%	1.67%	-18.68%	20.10%	-0.25%	8.39%	4.90%	4.03%	8.92%	6.34%
iShares MSCI ACWI ex US ETF	12.67%	10.48%	7.48%	-16.01%	15.47%	5.19%	6.20%	6.75%	4.95%	10.95%	6.20%

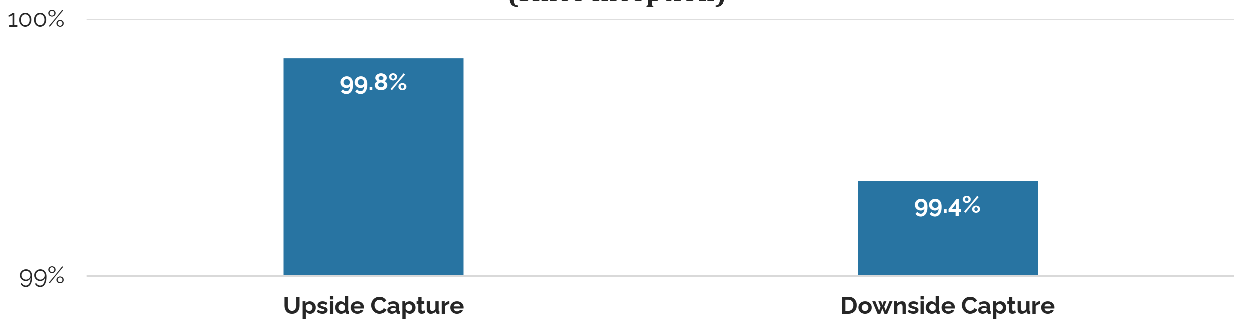


Source: U.S. Bank, Morningstar Data; Inception 1/31/2019; the period "2019*" reflects returns from inception through 12/31/2019. One cannot invest directly in an index. See performance disclosures.



Source: U.S. Bank, Morningstar Data; Inception 1/31/2019. One cannot invest directly in an index. See performance disclosures.

Distillate INTL FSV Strategy: Upside & Downside Capture vs. ACWI ex-U.S. ETF (since inception)



Source: Zephyr Analytics, see definition

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Top Contributors and Detractors From Relative Performance:

INTL FSV Strategy: Owned Stocks 2025 YTD Impact to Rel Returns (vs. ACWI Ex U.S.)

Top Contributors	Impact	Largest Detractors	Impact
ALIBABA GROUP HOLDING	1.16%	TFI INTERNATIONAL INC	-0.36%
THALES SA	0.75%	TAIWAN SEMI	-0.22%
ROCHE HOLDINGS LTD	0.63%	DR ING HC F PORSCHE AG	-0.20%
GOLD FIELDS LTD	0.54%	JD SPORTS FASHION PLC	-0.19%
HARMONY GOLD MINING	0.50%	CHINA COAL ENERGY	-0.17%

Rebalance Summary:

INTL FSV Strategy: Portfolio Changes During Recent Quarterly Rebalancing

Largest Purchases	Weight		Largest Sales	Weight	
Novartis AG	2.0%		Alibaba Group Holding	-3.8%	
JD.com, Inc. Class A	1.4%		Siemens Aktiengesellschaft	-1.9%	
Ambev SA	1.2%		Thales SA	-1.5%	
Largest Adds	**Weight**	**Previous**	**Largest Trims**	**Weight**	**Previous**
Taiwan Semiconductor	2.0%	1.2%	Heidelberg Materials AG	1.1%	1.4%
Kia Corporation	1.6%	1.0%	Gold Fields Limited	1.0%	1.2%
Shin-Etsu Chemical Co Ltd	1.2%	0.7%	Roche Holding Ltd	3.0%	3.2%
Rebalance Calculation Date:	**3/21/2025**				

INTL FSV Portfolio Characteristics*

	INTL FSV	ACWI Ex U.S. ETF
Free Cash Yield to Mkt Cap[1]	8.5%	5.2%
Free Cash Yield to EV[1]	7.4%	4.4%
P/E[2]	11.1	13.3
Leverage[3]	0.5	1.4
Cash Flow Stability[4]	0.78	0.54
Dividend Yield	3.5%	3.2%

*as of 3/31/2025, see methodology endnotes.

INTL FSV Portfolio Region Weights

Region	INTL FSV	ACWI Ex U.S. ETF
Europe	43.2%	46.7%
Japan	19.5%	11.6%
Asia Ex China & Japan	14.2%	15.5%
China & Hong Kong	9.8%	11.9%
Americas	9.6%	12.5%
Middle East & Africa	3.6%	1.9%

*as of 3/31/2025

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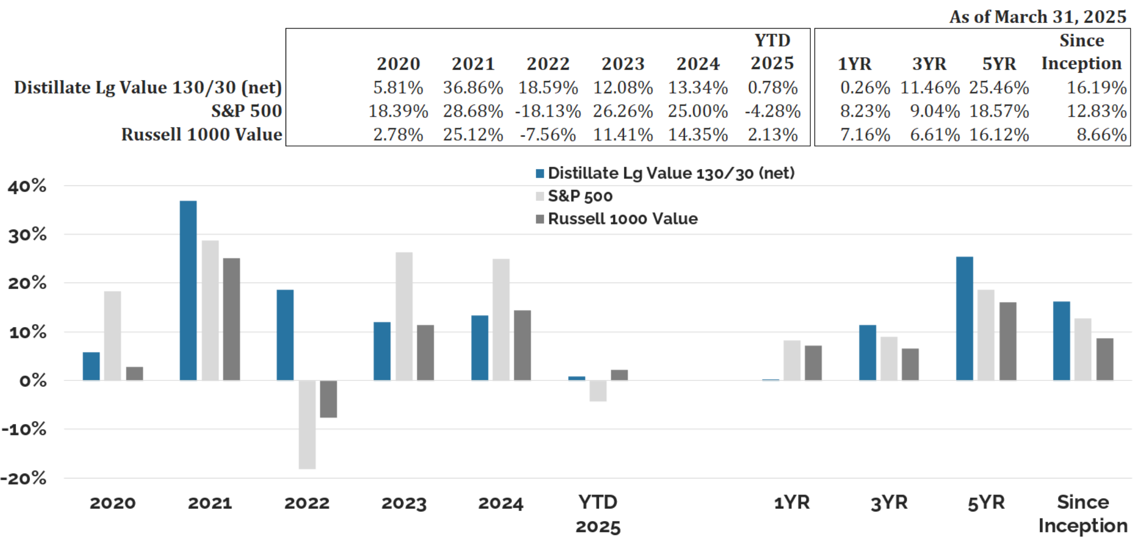
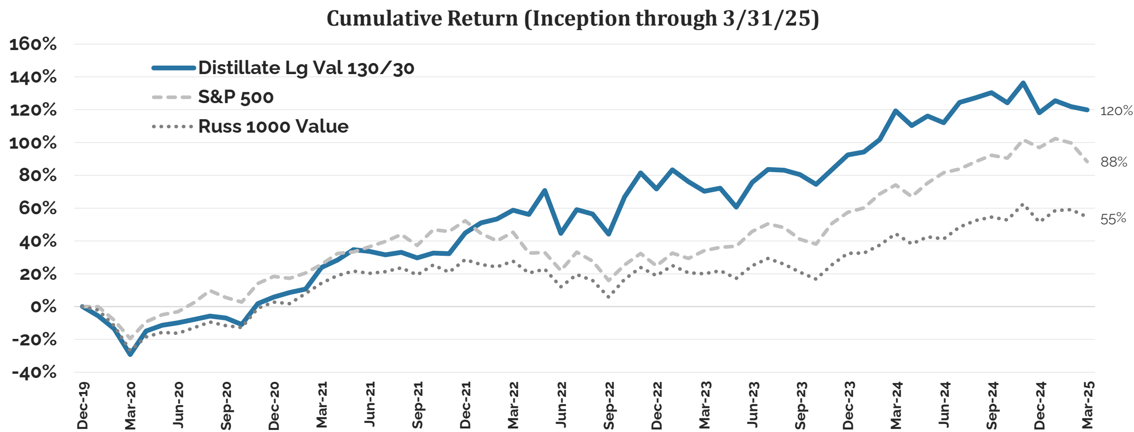
U.S. Large Cap Value 130/30 Composite Performance:



As of March 31, 2025

	2020	2021	2022	2023	2024	YTD 2025	1YR	3YR	5YR	Since Inception
Distillate Lg Value 130/30 (net)	5.81%	36.86%	18.59%	12.08%	13.34%	0.78%	0.26%	11.46%	25.46%	16.19%
S&P 500	18.39%	28.68%	-18.13%	26.26%	25.00%	-4.28%	8.23%	9.04%	18.57%	12.83%
Russell 1000 Value	2.78%	25.12%	-7.56%	11.41%	14.35%	2.13%	7.16%	6.61%	16.12%	8.66%

Source: U.S. Bank, Morningstar Data; Inception 12/31/2019. One cannot invest directly in an index. See performance disclosures.



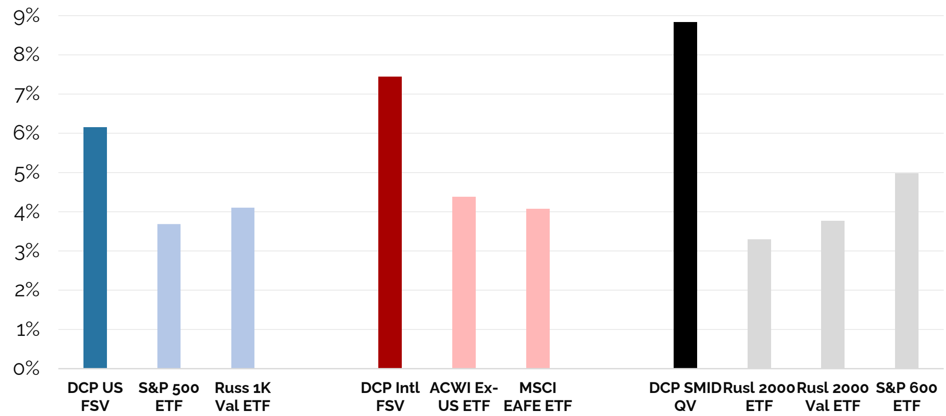
Source: U.S. Bank, Morningstar Data; Inception 12/31/2019. One cannot invest directly in an index. See performance disclosures.

U.S. Value 130/30 Portfolio Characteristics*	Long	Short	S&P 500
Free Cash Yield to Mkt Cap[1]	9.2%	-0.2%	4.1%
Free Cash Yield to EV[1]	7.3%	0.4%	3.7%
P/E[2]	11.4	24.6	20.2
Leverage[3]	1.2	1.7	1.0
Fundamental Stability[4]	0.57	0.57	0.70
Dividend Yield	2.0%	1.3%	1.4%

*as of 3/31/25, see methodology endnotes.

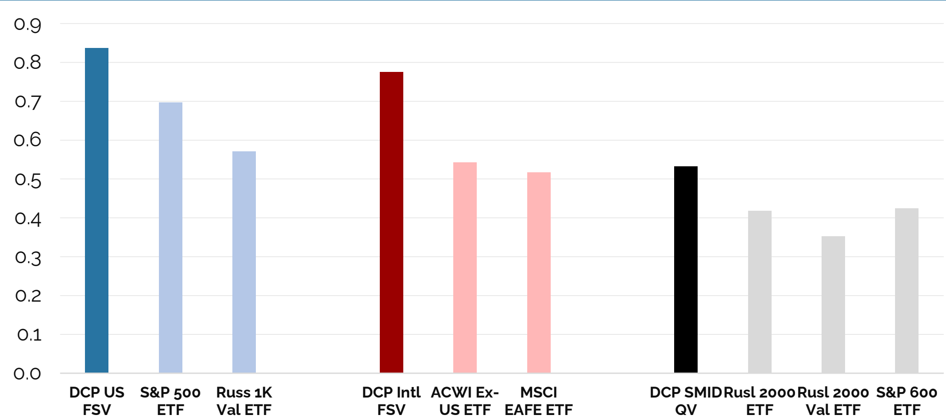
Past performance does not guarantee future results. See disclosures. Statistical data is sourced from FactSet.

Valuation: Next 12-Month Free Cash Flow to Enterprise Value



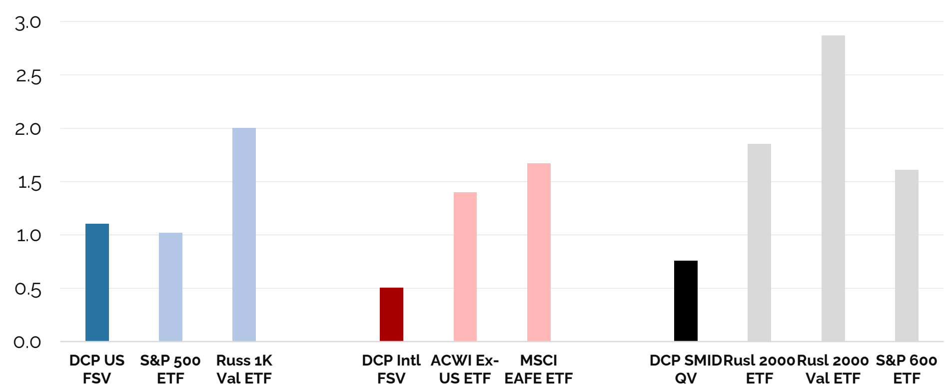
Source: FactSet, See end-notes for methodology. As 3/31/2025

Quality: Distillate's Cash Flow Stability Score



Source: FactSet, See end-notes for methodology. As of 3/31/2025

Quality: Net Debt to Adjusted EBITDA



Source: FactSet, See end-notes for methodology. As of 3/31/2025

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Distillate claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. To receive a GIPS Report and/or our firm's list of composite and broad distribution pooled funds descriptions please email your request to __info@distillatecapital.com.__

The U.S. Dollar is the currency used to express performance. Returns are presented net of management fees and include the reinvestment of all income. For non-fee-paying accounts, net of fee performance was calculated using a modeled management fee equal to the highest investment management fee that may be charged for the applicable composite (see fee schedule below). For accounts calculated with a per share, net-of fee NAV, gross performance was calculated by adding back the unitary fee associated with that fund. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

The investment management fee schedule for the strategies discussed are as follows: 0.39% for U.S. Fundamental Stability & Value; 0.55% for U.S. Small/Mid Quality & Value; 0.79% for U.S. Large Cap Value 130/30; and 0.55% for International Fundamental Stability & Value. Management fees may vary and are negotiable.

Data for the Firm's investment strategies are based on a representative account for each composite. Actual holdings and performance may differ between accounts or vehicles offered by the Firm due to the size of an account, client guidelines, or other constraints and restrictions related to that account or vehicle.

This material is provided for informational purposes only and is not intended as an offer or solicitation for the sale of any financial product or service or as a recommendation or determination by Distillate that any investment strategy is suitable for a specific investor. Investors should seek financial advice regarding the suitability of any investment strategy based on their objectives, financial situations, and particular needs. The investment strategies discussed herein may not be suitable for every investor. This material is not designed or intended to provide legal, investment, or other professional advice since such advice always requires consideration of individual circumstances. If legal, investment, or other professional assistance is needed, the services of an attorney or other professional should be sought. The opinions, estimates, and projections presented herein constitute the informed judgments of Distillate and are subject to change without notice. Any forecasts are subject to a number of assumptions and actual events or results may differ from underlying estimates or assumptions, which are subject to various risks and uncertainties.

All investments in securities, options and derivatives involve a risk of loss of capital and no guarantee or representation can be made that an investment will generate profits or that an investment will not incur a total loss of invested capital. __Past performance does not guarantee future results__ and there can be no assurance that the future performance of any specific investment, investment strategy, or product will be profitable, equal any corresponding indicated historical performance level(s), or prove successful. Investment returns and value will fluctuate in response to issuer, political, market, and economic developments, which can affect a single issuer, issuers within an industry, economic sector or geographic region, or the market as a whole. Furthermore, nothing herein is intended to imply that Distillate's investment strategies may be considered "conservative", "safe", "risk free" or "risk averse." Portfolio holdings and sector allocations are subject to change at any time and should not be considered recommendations to buy or sell any security. The information in this presentation has been obtained or derived from sources believed to be reliable, but no representation is made as to its accuracy or completeness.

This presentation contains forward looking statements, which can be identified by the use of forward-looking terminology such as "may", "will", "should", "expect", "anticipate", "target", "project"," estimate", "intend", or "believe", or the negatives thereof or any other variations thereon or other comparable terminology. Because such forward looking statements involve risk and uncertainties, actual results may differ materially from such expectations or projections. Any such forward-looking statements should not be construed to be indicative of the actual events that will occur nor should they be considered guarantees of future events in any form.

The __U.S. Fundamental Stability & Value__ composite seeks to distill a starting universe of large cap U.S. equities into only the stocks where quality and value overlap using Distillate's proprietary definitions. Its goal is to achieve superior compounded long-term returns by limiting downside in periods of market stress, while still providing strong performance in up markets. This composite was created in May 2017.

The __U.S. Small/Mid Cap Quality & Value__ composite seeks to distill a starting universe of small- and mid-cap U.S. equities into only the stocks where quality and value overlap using Distillate's proprietary definitions. Its goal is to achieve superior compounded long-term returns by limiting downside in periods of market stress, while still providing strong performance in up markets. This composite was created in March 2019.

The __International Fundamental Stability & Value__ composite seeks to distill a starting universe of large- and mid-cap non-U.S. equities into only the stocks where quality and value overlap using Distillate's proprietary definitions. Its goal is to achieve superior compounded long-term returns by limiting downside in periods of market stress, while still providing strong performance in up markets. This composite was created in January 2019.

The __U.S. Large Cap Value 130/30__ composite seeks long-term capital appreciation by holding approximately 130% of an account's value in the most attractively valued large cap U.S. stocks measured using Distillate's proprietary free cash flow valuation method. The market exposure in this composite is brought back to approximately 100% by selling short 30% of an account's value of the least attractively valued stocks among the same starting set. This composite was created in December 2019.

__Free Cash Flow__ refers to a company's operating cash flow, less its capital expenditures. __Enterprise Value__ refers to a company's market capitalization plus its net debt balance. __Free Cash Flow to Enterprise Value Yield__ refers to a company's or group of companies' free cash flow divided by the company's (or companies') Enterprise Value, with a higher resulting ratio indicating a more attractive valuation. This metric is a valuation measure and not a form of investor yield. __Normalized Free Cash Yield (or Distilled Cash Yield)__ refers to the firm's proprietary valuation measure that looks at estimated, adjusted free cash flow relative to a company's adjusted enterprise value. References to historical stocks that ranked well using this methodology refer only to these stocks' historical valuation and not their inclusion in any actual or hypothetical strategies/accounts managed by Distillate Capital Partners LLC. This metric is a valuation measure and not a form of investor yield. __Fundamental (or Cash Flow) Stability__ is Distillate Capital's proprietary measure of through-cycle cash flow stability with a higher value indicating greater stability. __Leverage__ is based on Distillate Capital's proprietary measure of indebtedness which looks at the ratio of adjusted net debt to an adjusted measure of forecast Earnings Before Interest, Taxation, Depreciation, and Amortization (EBITDA.)

Methodology note for __Figures including free cash flow yield (FCF)__ or __free cash flow to enterprise value yield (FCF/EV):__ figures reflect consensus estimates

of next-twelve-months (NTM) FCF in comparison to market capitalization or enterprise value (EV) for the relevant portfolio/strategy or benchmark. Stocks without data are excluded and portfolios are reweighted accordingly. Stocks with FCF/Market Cap or FCF/EV values of greater than 50% or less than -20% have been eliminated to avoid distorting overall averages.

Methodology Notes for ***Portfolio Characteristics Tables (Appendix)****: [1]**Free Cash Yield to Market Cap and Enterprise Value (EV)** are based on the next-twelve-month free cash flow estimates relative to market capitalization and EV, which adds Distillate's proprietary measure of indebtedness. Stocks without estimates in the are excluded and the remaining names are reweighted based on those exclusions. [2]**P/E** is based on consensus estimates for next-twelve-months and excludes P/Es over 250 and under 0 to avoid the distortion from outliers. [3]**Leverage** is based on Distillate Capital's proprietary measure of indebtedness which looks at the ratio of adjusted net debt to an adjusted measure of forecast Earnings Before Interest, Taxation, Depreciation, and Amortization (EBITDA.) [4]**Fundamental stability** is Distillate Capital's proprietary measure of through-cycle cash flow stability with a higher value indicating greater stability. [5]**Negative FCF weight** is measured as the weight of stocks with negative free cash estimate as a share of those with any estimate.*

*The **S&P 500 Index** is an index of roughly the largest 500 U.S. listed stocks maintained by Standard & Poor's. The **S&P 500 Equal Weight Index** is an index of the same stocks as the S&P 500 Index, but weights the constituents equally. The **iShares Russell 1000 Value ETF** is an investable benchmark used as a proxy for its underlying index, the **Russell 1000 Value Index**, an index of U.S. listed stocks that possess attractive valuation as measured by FTSE Russell. The **iShares MSCI ACWI Ex-US ETF** is an investable benchmark used as a proxy for its underlying index, the **MSCI ACWI ex USA Index**, an index managed by MSCI representing large and mid cap stocks outside of the U.S. The **iShares Russell 2000 ETF** and **iShares Russell 2000 Value ETF** are investable benchmarks used as a proxies for the underlying indexes of the **Russell 2000 Index** (an index of U.S. listed small cap stocks) and the **Russell 2000 Value Index** (an index of U.S. listed small cap stocks that possess attractive valuation as measured FTSE Russell).*

Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs, which would reduce returns.

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