Third Quarter 2025 (October 1, 2025)

The third quarter was a particularly difficult quarter of relative performance for all three Suncoast Equity Growth portfolios: **SEM Select Growth**, **SEM Dividend Growth** and **SEM Small to Mid-Cap**, in comparison to the general market indexes. While returns have lagged, our portfolio company profits continue to grow double digits, faster than the indices, and we expect relative returns will eventually track relative profit growth. In our portfolio letters we cover company specific updates and in this general commentary we share our thoughts on the overall environment.

2025's V-Shaped Recovery: From Tariffs Scare to AI Exuberance

We have witnessed a V-shaped market recovery following the peak tariffs that sank the S&P 500 index to a year-to-date intraday low of -18% in early April. Increased clarity on fiscal, monetary and trade policy and a heightened exuberance for generative Artificial Intelligence have since powered the S&P 500 to a series of all-time highs in September. While many AI-themed companies offer exciting innovation potential, many also face financial futures subject to an extremely wide range of outcomes. At Suncoast, we seek to grow your capital within a tighter range of outcomes via companies, even AI-leading ones like **Nvidia** and **Microsoft**, that have already delivered superior earnings and free cash flow growth and are expected to continue doing so because of an enduring competitive advantage.

An example of the current market rally's zeitgeist is Tesla. Shares for the automaker have increased 100% since April 8th despite weakening business fundamentals. In each of the last three years, Tesla's auto deliveries, sales, earnings, free cash flow, and margins have declined, and market share has now been halved. Trading at an extraordinary 245 times 2025 profit levels, stockholders are not valuing Tesla as an automaker, but as a technology company with the potential for vast profits from large markets in autonomous vehicles, humanoid robots and AI. While we admire the company and Elon Musk's extraordinary ability to innovate at scale, we do not have a line of sight into Tesla's long-term competitive position. In addition, its volatile cash flows and low return on capital do not meet the thresholds of our **SEM Disciplined Investment System (SEM-DIS)**. For these reasons, we must remain on the sidelines.

Not a "Safety First!" Market

Like Warren Buffett, we have used Value Line investment data to screen, analyze and monitor portfolio holdings for three decades. Value Line provides a host of financial metrics, including a Safety Ranking and an Earnings Predictability figure for 1,700 stocks. Safety Rankings are a measure of a company's relative risk profile. The lowest risk stocks have Safety Rankings of 1 and the highest risk stocks are rated 5. Safety Rankings are based on measures of financial strength, like balance sheet soundness and cash flow, as well as stock price stability. Suncoast portfolios have been characterized with higher Safety Rankings than average. Our ideal company offers not only relative safety but also strong earnings consistency and growth. The Value Line Earnings Predictability figure provides a relative ranking of such. Rankings of 80-100 are considered superior and tend to power forward independent of the economic cycle or competition. Stocks with low scores are cyclical in nature and tend to suffer severe earnings contractions. We try to construct a portfolio with superior safety, earnings predictability and business momentum. While the past is not prologue, Value Line studies and our own historical track record support this disciplined approach over a market cycle. Our current **SEM Select Growth** portfolio has a median Earnings Predictability of 83 and a Safety Ranking of 2.

In the tables below you can see the stocks at the bottom of each metric of Safety Rankings and Earnings Predictability have dominated returns in 2025. They underperformed leading up to peak tariff uncertainty in April but have roared since. We do not believe this trend is sustainable as these companies are definitionally cyclical and often speculative.

Returns by Value Line Safety Ranking and Earnings Predictability

Value Line Safety Ranking	12/31 - 4/8	4/8 - 9/19	YTD 9/19
1	0%	10%	9%
2	-6%	13%	5%
3	-18%	34%	9%
4 & 5	-20%	90%	49%

Value Earnings Predicability	12/31 - 4/8	4/8 - 9/19	YTD 9/19
80-100	-7%	15%	5%
60-79	-15%	28%	7%
50-59	-15%	34%	13%
20-40	15%	30%	10%
0-19	-18%	56%	24%

Source: Value Line as of 9/19/25

We are seeing a similar return spread for high quality dividend paying stocks versus high beta names.

	12/31 - 4/8	4/8 - 9/30	YTD 9/30
S&P 500 High Beta Index Returns	-24%	64%	25%
S&P 500 Dividend Aristocrats Returns	-8%	15%	5%

Source: FactSet, S&P 500 Beta Index tracks the 100 stocks in the S&P 500 that exhibit the highest sensitivity (beta) to overall market movements, while the S&P 500 Dividend Aristocrats tracks constituents that have increased dividends every year for at least 25 consecutive years.

Other periods where we witnessed such trends include the pre-tech wreck period of 1998-1999, the pre-global financial crisis years of 2003-2006, in 2016 during the lead up to significant US corporate tax cuts the next year, and finally in the pandemic-fueled stimulus years of 2020-2021. In each of the following periods, the market rotated (while typically gyrating) into companies with more sustainable earnings and stronger balance sheets. It can be challenging not chasing short-term returns, but experience reminds us to stay disciplined.

<u>"I'll See Your $100 billion and Raise You $100 billion!"</u>

Regarding a company's intrinsic value, we start with the premise that a business, private or public, is ultimately worth what money you can take out of it, or in other words, its ability to generate free cash flow. Imagine two local businesses with offices next to each other in your town. Both generate $10 million in sales per year and have similar profit margins, but one requires $300,000 per year of ongoing reinvestment in equipment to ensure future revenues, while the other requires $2 million. Perhaps the former is a niche benefits consultant that needs to maintain a small, proprietary tech platform, while the other is an independent oil producer that needs to reinvest more significantly in wells to ensure future volumes. The benefits consultant is fundamentally worth more than the oil producer as more profits are "free" to be taken home by its owners or used for other growth options.

A development we are monitoring closely across our companies and within the economy is the lowered free cash flow due to gargantuan AI investments. While S&P 500 earnings have annualized 11% growth in '24-25, free cash flow growth has trailed at 5.8%. Companies are making headlines seemingly every week with AI investment announcements in the tens or hundreds of billions of dollars. Oracle, which we don't currently own, surprised the investment community on their September 9th earnings call, announcing they had $450 billion in contracted cloud AI revenue deals, $300 billion alone coming from ChatGPT innovator, OpenAI. Regarding ORCL, we love the growth inflection, but we expect its annual AI spending (capital expenditures) to exceed its cash flow for many years; consequently, it does not meet our SEM-DIS standards. While we own direct beneficiaries of the historic AI investment era such as companies who sell or lease AI chips, networking and supporting data center equipment and services like **Nvidia**, **Broadcom** and **Eaton**, we also own companies buying said equipment, like **Meta**, **Microsoft** and **Alphabet**. The common factor across them? AI is already driving incremental revenues, thereby reducing, but not eliminating, the risk their large AI investments fail to generate adequate returns. In summary, we are pleased with these businesses' growth prospects, but we continue to evaluate all individual companies carefully as it relates to AI spending versus potential growth and AI business model disruption or enablement.

"Back to the Future": 2016-2017, with a Twist

The last time we witnessed such strikingly similar market dynamics was in 2016 when Select Growth trailed the S&P 500 over 10 percentage points (1000 basis points) . Then as now, our portfolio earnings per share (EPS) growth was superior. Fortunately, the strong portfolio EPS growth in both 2016 and the following year led to strong 2017 portfolio return outperformance. A similar environmental dynamic between 2025 and 2016 is the anticipation of a new presidential administration and the prospects for meaningful tax and trade policy changes. The twist today includes AI at the forefront. The summary takeaway is that we focus on what we can control - company fundamentals - and let the market eventually weigh earnings fully. We may not see much change in relative performance across our three portfolios between now and the end of year. As our earnings growth compounds we believe our portfolio values will eventually catch up and potentially outperform as they have done historically. We thank you for your continued confidence and look forward to what's ahead.

Sincerely,

Don	*Dan*	*Amy*	*Eric*
Donald R. Jowdy	Daniel T. McNichol	Amy A. Lord, CFA	Eric K. Lynch
CIO	President	SVP / Co-PM	Managing Director/ Co-PM

Investment advisory services are offered through Suncoast Equity Management, LLC, a Securities and Exchange Commission Registered Investment Advisor.

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