

2024 Annual U.S. Equity Review

JANUARY 2025

Kevin: Welcome to Dodge & Cox's 2024 U.S. Equity Review. I'm Kevin Johnson, VP at Dodge & Cox, and I've been here for 35 years. It's my pleasure to have Phil Barret, Senior VP at Dodge & Cox, who has been with the firm for over 20 years, who serves on the U.S. Equity, Balanced Fund, and Emerging Markets Equity Investment Committees. Thanks for joining us, Phil.

Phil: Hi, Kevin. I'm happy to be here and appreciate the opportunity to share our thoughts with those of you joining us today.

Kevin: Over the next 15 minutes, we'll provide an update on the U.S. equity market backdrop, our performance, and where we have been finding opportunities. Before we go into specifics, do you have any headline thoughts on 2024, Phil?

Phil: Kevin, the headline thoughts are that market returns were strong in 2024, with the S&P 500 up over 25% and up over 50% over the past two years. However, those returns have been driven by a small number of large [Information] Technology (IT) stocks that trade at high valuations, leading to wide valuation dispersions in the market. We believe this market environment presents attractive opportunities for active, value-oriented, [and] long-term investors like Dodge & Cox. The Stock Fund portfolio is very different from the broader market today, and we believe well positioned against various economic scenarios.

Kevin: With that as context, can you set the stage for what happened in U.S. equities during 2024?

Phil: Well, Kevin, 2024 saw a continuation of trends in 2023, with growth stocks outperforming as you can see in the top-left chart. Turning to the top-right chart, most sectors delivered negative absolute returns in the fourth quarter of 2024. The biggest story has been, over the past two years, the outperformance of the largest stocks in the Index. As you can see in the bottom left, the "Magnificent Seven" has accounted for the bulk of the outperformance of the S&P 500 relative to the Russell 1000 Value over the past two years and over the most recent quarter. Excluding those seven stocks, the S&P 493¹ has performed more similarly to the Russell 1000 Value. As the bottom-right chart shows, more expensive stocks have been the place to be over the past two years. Higher valuation stocks have outperformed lower valuation cohorts in both 2023 and 2024.

Kevin: So, a small number of relatively expensive stocks have led market returns. The chart in the lower right suggests that higher valuation stocks have done better than others, which implies that momentum has also played a role. That sounds like a challenging market environment for value-oriented managers. How has the Committee responded to these market dynamics?

Phil: Well, Kevin, our process hasn't changed. We invest based on a three- to five-year investment horizon. We employ a rigorous, bottom-up, iterative, and collaborative process to diligence companies. This investment process and time horizon has led to a portfolio that is very different from the broader market. The Stock Fund has very high active share. Our portfolio is cheaper than the S&P 500 and Russell 1000 Value, whether measured by price-to-earnings ratio (P/E), price-to-cash flow, price-to-sales, or price-to-book. In a more expensive market, we are maintaining our long-term focus on valuation in relation to company fundamentals.

Kevin: In this environment, we've maintained our valuation orientation and discipline, and our portfolio looks very different than the major indices. It was a strong year for equity returns, as you mentioned. How did the Stock Fund perform?

Phil: Absolute returns for the Stock Fund were strong at 14.5%.² As you can see on the table, the Stock Fund outperformed the Russell 1000 Value but underperformed the S&P 500 in 2024.

Kevin: A long-term time horizon has always been important to our approach, and we encourage our investors to think longer term as well. How has the Fund done over longer time periods?

Phil: Over longer periods, as you can see on this table, the Stock Fund has outperformed the Russell 1000 Value, but underperformed the S&P 500. This is true over all periods listed in the table. Relative returns reflect what has been a challenging period for value-oriented strategies. Valuation dispersions in the market have expanded to historically wide levels. We are encouraged that historically, such valuation dispersions have presented attractive opportunities for value-oriented investors like ourselves.

Kevin: Thank you for providing that longer-term perspective. Let's discuss 2024 in more detail. What were some of the key factors in the Fund's performance relative to the S&P 500?

Returns represent past performance and do not guarantee future results. Investment return and share price will fluctuate with market conditions, and investors may have a gain or loss when shares are sold. Fund performance changes over time and currently may be significantly lower than stated above. Performance is updated and published monthly. Current month-end performance can be obtained at dodgeandcox.com or call 800-621-3973.

Phil: Kevin, relative to the S&P 500, our underweight in IT and overweight in Health Care accounted for the bulk of underperformance.³ To the positive, Financials and Industrials holdings delivered strong contributions. Some of those contributors included GE Aerospace, Fiserv, Wells Fargo, and BNY [Mellon].⁴ Breaking it down further, not holding NVIDIA was by far the largest individual detractor relative to the S&P 500 from Fund performance. Not holding NVIDIA accounted for 4% relative underperformance alone versus that Index. Excluding Magnificent Seven stocks, the Stock Fund realized similar returns to the S&P 500 in 2024.

Kevin: Artificial intelligence or AI has gotten a lot of attention recently. How are we thinking about AI, and why don't we own NVIDIA?

Phil: Well, Kevin, we're spending considerable time on AI. We believe in the importance of AI as a major technological innovation. However, we're looking to benefit in ways that do not involve excess speculative risk. We have holdings, including Alphabet, that are major participants in the market. Per NVIDIA specifically, its current market capitalization discounts what we believe it to be outsized profit margins in a near-monopoly position extending far into the future. While current demand exceeds supply for GPUs, over our three- to five-year investment horizon, we are more skeptical NVIDIA's market share and profit margins can sustain at current levels and that the market will capitalize those earnings at an outsized P/E multiple. In particular, there's a large gap between expected NVIDIA revenue and implied end-user revenue required to justify that data center investment. Today, enterprises are aggressively investing, but GPU purchases can be cut back if an adequate return on investment doesn't materialize.

Kevin: Long term, sounds like we're very optimistic about AI, but in the near term, we're skeptical about company's ability to maintain their market share in a more competitive environment. You mentioned the Fund underperformed the S&P 500 but did outperform the Russell 1000 Value Index. What were the key contributors and detractors relative to the [Russell 1000] Value Index for the year?

Phil: Against the Russell 1000 Value Index, the key contributors were broadly stock selection specific, Industrials, Consumer [Discretionary], and Communication Services holdings. Top contributors included Fiserv, Alphabet, Wells Fargo, BNY [Mellon], and JCI (Johnson Controls International). These contributors were [mostly] offset by poor results from Health Care.

Kevin: Thank you for that, Phil. Let's talk a little about portfolio positioning. Where is the Committee finding value?

Phil: During 2024, our largest adds were to Health Care positions, again the largest underperformer over the period. This sector is facing headwinds from adverse regulatory, medical loss, and R&D (research and development) cycles. However, we like the combination of low valuations, low economic sensitivity, secular growth, and [the] potential for profit margin improvement over the next three to five years .

Kevin: Within Health Care, health care services have been an area of increase. What opportunities is the Committee seeing?

Phil: We'd highlight a few, Kevin. During 2024, we started a position in Avantor, a key supplier to biopharma companies. Market demand has moderated from a pandemic-era boom. However, customer destocking has led to revenue pressures that we believe are temporary against an attractive valuation. We're also finding value in Medicare Advantage providers such as Humana and CVS [Health]. The government program for seniors is experiencing dual adverse cycles related to medical loss rates and government reimbursement levels. These adverse headwinds are leading to lower profit margins. Over time, we believe that insurers can reprice their services, such that profit margins will recover, and valuations are very low against those potential earnings.

Kevin: Within Health Care, there have been some concerns about the regulatory environment, particularly as we have a new administration here in the United States. How is the Committee thinking about regulatory risk?

Phil: We're paying close attention and analyzing proposals in detail. Broadly, we believe that proposed changes to regulation are manageable, such as price transparency for PBMs (pharmacy benefit managers). At a high level, health insurers are important entities in managing the rate of growth in health care spending. To the extent that is a policy priority, that key role is unlikely to diminish, and this makes insurers key partners to governments in controlling the cost of Health Care.

Kevin: Valuations are much lower in the area, and we continue to feel relatively positive about the longer-term outlook for many of these companies. It seems to fit very well with our somewhat contrarian approach. Besides Health Care, are there other areas we are increasing?

Phil: Well, Kevin, we're also finding value in industrial and chemical companies, some of which are facing idiosyncratic cyclical pressures. We started a position in Air Products, an industrial gas distributor with attractive growth prospects in a highly consolidated industry. The company has invested heavily in speculative projects that are now coming online and [we believe] will contribute significantly to outsized EPS (earnings per share) growth in the future. We also started a position in Ashtead, a leading heavy equipment rental company. The company has scale advantages and a growth runway through consolidation and is facing what we believe is a temporary lull in demand.

Kevin: Even in a market that appears to be fully valued, our bottom-up, fundamental approach has uncovered some very interesting opportunities. The Fund also has exposure to REITs (Real Estate Investment Trusts) and Utilities, which is relatively new. Can you discuss what has led the Committee to this decision?

Phil: REITs and Utilities are two sectors that we have very lightly owned over the past two decades during the long period of low rates. But those industries are now more interesting to us as valuations have reset. We like the combination of low economic sensitivity, high capital return, and predictable growth, now at more attractive valuations. In 2024, we started a position in AEP, a regulated utility [company] with

significant scope for operating improvement, trading at a discounted valuation. We also started a position in Sun Communities, a leading operator of manufactured housing parks. We liked the predictable, recession-resistant revenue, scope for operating improvement, and high capital return.

Kevin: What have been the most significant changes in the portfolio over the course of 2024?

Phil: Well, Kevin, we've largely trimmed holdings where we believe the valuations are excessive and/or don't compensate us well for taking economic risk. During 2024, we trimmed Financials on strength after adding in 2023 during a period of deep pessimism surrounding the regional banking turmoil. We continue to trim Technology holdings. Notably, the Fund's weighting in the IT sector is now the lowest it has been since the TMT (Technology, Media, and Telecommunications) bubble in early 2000, largely driven by valuation concerns.

Kevin: Phil, I noticed in looking at our 10 largest holdings shown on page nine, that Alphabet, one of the Magnificent Seven, is among our top 10 positions. Is this a long-term holding of the Fund, and why does the team find it attractive?

Phil: Yes, Kevin. Alphabet has been a Fund holding for over a decade. It is a very high-quality franchise. The company is effectively a toll taker on the digital economy. It has outsized growth [and] high barriers to entry in its core search product. We believe that AI is more of an opportunity than a risk for the company, which is a somewhat contrarian viewpoint. Today, Alphabet trades at 21 times forward earnings, which we believe is reasonable against its growth prospects. And importantly, we believe the valuation is even more attractive on a sum-of-the-parts basis due to loss-making other segments that are quite valuable.

Kevin: So our approach of evaluating each company on its own merits is what has led us to taking a significant position in Alphabet. Thank you, Phil, for elaborating on the key takeaways that you shared in the opening. Recent market returns have been driven by a small number of large, relatively expensive stocks. [This] has led to wide valuation dispersion, which we believe creates opportunities for active, value-oriented managers like Dodge & Cox. The Stock Fund portfolio is very different from the broader market. It's diversified and, in our opinion, is well-positioned for various economic scenarios. Would you add anything to that summary?

Phil: Kevin, I think you've summarized it well.

Kevin: Thank you, Phil, for joining me today and for your insights. We also want to thank those listening for your interest in our discussion. We're grateful for the confidence that you placed in Dodge & Cox. We look forward to speaking with you soon. Thank you.

Dodge & Cox Stock Fund — Class I SEC Standardized Average Annual Total Returns as of December 31, 2024: 1 Year 14.52%, 5 Years 11.99%, 10 Years 10.85%. Fund and Index standardized performance is available on our [website](#).

Stock Fund's Ten Largest Positions (as of December 31, 2024): Fiserv, Inc. (4.0% of the Fund), The Charles Schwab Corp. (4.0%), Alphabet, Inc. (3.3%), Wells Fargo & Co. (3.2%), RTX Corp. (3.2%), MetLife, Inc. (2.9%), Johnson Controls International PLC (2.8%), Sanofi SA (2.5%), Occidental Petroleum Corp. (2.3%), and FedEx Corp. (2.3%).

1. The S&P 493 Index is a market-weighted index that excludes the Magnificent Seven companies from the S&P 500 Index.
2. All Fund performance results are for the Stock Fund's Class I shares.
3. Unless otherwise specified, all weightings and characteristics are as of December 31, 2024.
4. The use of specific examples does not imply that they are more or less attractive investments than the Fund's other holdings.

See [Disclosures](#) for a full list of financial terms and Index definitions.

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