

ON-DEMAND AUDIO TRANSCRIPT

# 2025 Annual U.S. Equity Review

**Kevin:** Welcome to Dodge & Cox's 2025 U.S. Equity Review. I'm Kevin Johnson, Vice President at Dodge & Cox for 36 years, and it's my pleasure to have Phil Barret, a Senior Vice President at Dodge & Cox for 21 years, who serves on the U.S. and Emerging Markets Equity Investment Committees. Thanks for joining, Phil.

**Phil:** It's a pleasure to be here. I'm happy to share today our thoughts with those of you joining.

**Kevin:** Over the next 15 minutes, we'll provide an update on the U.S. equity market, our performance, and where we've been finding opportunities. Before we go into specifics, though, Phil, do you have any headline thoughts on 2025?

**Phil:** I think a headline thought is when we look at the [Dodge & Cox Worldwide Funds] U.S. Stock Fund today, Kevin, it's a very different portfolio from the broader equity market. It's the output of a process that hasn't changed. We invest on a three- to five-year investment horizon; we employ a bottoms-up, iterative, and highly collaborative process to diligence companies; and that has resulted in a portfolio that has high active share, a low valuation relative to the S&P 500 [Index] and Russell 1000 Value [Index]. It's a Fund that's more diversified across sectors. It has a tilt towards more stable franchises. The bottom line is we think the Fund is well positioned for a variety of economic and market environments, particularly against indexes that have greater valuation, concentration, and cyclical risk.

**Kevin:** Thank you for that context, Phil. Can you set the stage for what happened in U.S. equities during 2025?

**Phil:** Well, Kevin, if you look on the slide up on the screen, for the third straight year, growth indices outperformed value indices; and that was driven, again, by the "Magnificent Seven," as you can see in the bottom left, that outperformed the broader market, though by a lesser extent in 2025 than in 2024.<sup>1</sup>

Once again, higher P/E (forward price-to-earnings) stocks outperformed lower P/E stocks, as you can see in the bottom right, and there was weak market breadth. Only about 35% of stocks outperformed the S&P 500 during the course of the year.

**Kevin:** Artificial intelligence (AI) was a very popular topic throughout the year and had a large impact on investor behaviour. Momentum did also play a role. It sounds like a challenging market environment

for value-oriented managers. How has the Committee responded to these market dynamics?

**Phil:** Well, I'd start by saying that, as a firm, we're big believers in gen (generative) AI. We're using it to enhance our investment process and throughout the firm. However, valuations of AI-related companies are high and profit pools in our view are very speculative [and] uncertain for many businesses. The S&P 500 has growing concentration and valuation risks related to gen AI stocks. The S&P 500 is expensive at about 23 times earnings, and eight stocks account for 37% of the Index.<sup>2</sup> All of the stocks, in one way or another, are linked to the [Information] Technology sector. As we looked at broader markets, the Russell 1000 Value [Index], for instance, is relatively stretched at 18 times earnings, and globally, equity indexes are closer to the higher end of their valuation histories than the lower end. And when we drill down on intra-sector valuations, those tend to be stretched as well. It's not just the [Information] Technology sector.

The U.S. Stock Fund, by contrast, is very different. It trades at a lower valuation of 14.7 times earnings. It has a high active share of over 80% against the S&P 500. The Fund holds only about 12% of the stocks in the S&P 500, and it has a lower beta at 0.87, which we would caution is a backward-looking metric. The bottom line is the U.S. Stock Fund has a higher weighting in companies that are less cyclical and/or cheaper.

**Kevin:** So, in a fully valued market environment, our portfolio looks quite different. It was a strong year for equity returns. How did the Fund perform in 2025?

**Phil:** The Dodge & Cox Worldwide Funds — U.S. Stock Fund's USD Accumulating Class delivered a return of 11.7% compared to 17.9% for the S&P 500.<sup>3</sup> Valuation dispersions have widened and today are quite wide versus history, and historically such valuation dispersions have portended well for future relative returns from value-based strategies. We like the opportunity set here a lot. We're finding a lot of opportunities. Many sectors and companies, in our view, are being overlooked, given market returns [have been] dominated by a handful of Information Technology stocks.

**Kevin:** Thank you, and we'll turn to where we're finding opportunities in a moment. But before we do, let's discuss 2025 in more detail. What were some of the key factors in the Fund's [USD Accumulating Class's] performance relative to the S&P 500?

**Phil:** Well, as you can see on the slide up, Industrials were a key contributor [to the USD Accumulating Class]. I'd call out RTX [Corporation] and JCI (Johnson Controls International) there as key stocks.<sup>4</sup> In terms of detractors, Financials and Communication Services were the largest detractors. There, three stocks really stood out: Fiserv, Charter [Communications], and Comcast.

**Kevin:** AI has gotten a lot of attention, as you mentioned earlier. How are we thinking about AI from an investment perspective, and why don't we own NVIDIA?

**Phil:** Well, we are spending a lot of time, as a firm, on gen AI. NVIDIA is a very important stock within the gen AI universe, and it's the largest stock in the world today at 8% of the S&P 500. NVIDIA has accrued the bulk of [its] profits related to AI data centre buildouts. However, we question whether growth rates and profit margins are sustainable over the next three to five years.

We expect over that horizon that semiconductor competition will increase. The return on invested capital for data centres is still quite speculative. It relies on large language models achieving differentiation that leads to outsized monetisation that hasn't happened yet, and the technology is rapidly changing—the models, the compute needs, [and] the form factors. There's still a lot that's uncertain, and historically semiconductors have been a very cyclical sector. There's little recurring revenue in the business model.

Having said all that, we are finding some places of value in the semiconductor supply chain. In 2025, we started a position in TSMC (Taiwan Semiconductor Manufacturing Co.), which has a dominant position in mission-critical semiconductor fabrication. All of the big Technology companies, in one way or another, rely on TSMC. The stock traded off with tariff concerns around Liberation Day last year. It still has a relatively low valuation [at] 20 times earnings. One thing we like about TSMC is we see it as a winner no matter which semiconductor companies take or lose market share. It has a bottleneck position, which we believe gives it latent pricing power in the semiconductor supply chain.

I think this investment also highlights the benefit of our global research coverage. The company, of course, is based in Taiwan, and we believe we have the capability to go wherever we need to find value. And one thing I'll leave you with, Kevin: Information Technology is now about 35% of the S&P 500, but it's only 8% of the Fund. We are more cautious on the sector writ large, given high valuations that embed high expectations, but we are still finding value in spots.

**Kevin:** So, while we are underweight the broader market in Technology, we have been able to find some interesting opportunities. Let's talk more about portfolio positioning. Where is the Committee finding value?

**Phil:** Health Care is the largest weighting in the Fund at over 25%, and it's the biggest overweight against both the S&P 500 and Russell 1000 Value. We like the combination of low valuation and low economic sensitivity, and within the 25%, the weightings are well diversified between biopharma [Biotechnology and Pharmaceuticals] and [Life Science] Tools & Services companies.

We'd highlight Medicare Advantage providers as an attractive opportunity within that subset. We believe holdings in UnitedHealth, Humana, and CVS play well to our long-term investment horizon.

Medicare Advantage is a highly popular programme with senior citizens. It's also cost effective for the government, which creates a mutually beneficial dynamic. Profits in recent years have been squeezed by high Health Care utilisation rates and regulatory changes. However, we believe it's highly probable over the next three to five years that margins can improve. There's an oligopoly market structure where the Medicare Advantage industry is dominated by a few firms, which are redesigning their plans. We believe against potential earnings, with margin recovery, these stocks are very attractively valued, particularly against the earnings growth profile.

**Kevin:** So, Health Care is an area of emphasis for us. Another major allocation is Financials, but that seems to have somewhat of a twist, as we seem to be moving away from the more traditional banking sector.

**Phil:** That's correct. We've been highly invested in banks over the last decade. Our investment thesis around that sector has played out, and with outperformance, higher return on equity, and higher price-to-earnings ratios—as you would expect for disciplined investors—we have been reducing our weighting in more traditional banks. By contrast, we have been finding some value in other subsectors of Financials. Insurance brokers is one I'd call out. We started positions in Willis Towers Watson and Aon during the course of 2025.

Insurance brokers are a sector with attractive fundamentals. The business has low capital intensity [and] high recurring revenue. It's leveraged to rising cost of insurance with social inflation and building material inflation, so it's a sector that has seen very attractive earnings growth over the long term. There's a short-term overhang today with softening P&C (property and casualty) prices, which has caused valuations to come in. Over a three- to five-year horizon, we like this sector a lot. We think the outlook is much brighter, and we think valuations are attractive against potential EPS (earnings per share) growth.

**Kevin:** Speaking of Financials, Fiserv was a big detractor to [the USD Accumulating Class's] performance during the year. Could you walk us through what's happening there?

**Phil:** Well, Fiserv was the biggest detractor to performance and was quite disappointing during the course of the year. This is a company that, over the long term, has delivered strong performance. A change in CEO led [to a] sharp reset in growth and earnings expectations. Following that, the P/E multiple contracted from 20 times [earnings] to 8 times [earnings], which drove most of the underperformance.

**Kevin:** And what does the Committee do when stocks underperform like this?

**Phil:** Well, Kevin, with any greatly outperforming or underperforming stock, we have the same process. We approach the investment with a clean sheet of paper. We use a consistent three- to five-year

investment horizon. We gather and incorporate new facts. I think in the case of Fiserv, our assessment is that the franchise is largely intact. The new CEO is taking the right steps to address issues, and often with public market equity investments, market perceptions can fluctuate much more widely than underlying fundamentals. We think that is the case for Fiserv today. We think it is a very good deal from 8 times earnings and believe, in the next three to five years, it is an attractive opportunity.

**Kevin:** So, we are still seeing opportunities within Financials, although the opportunity set seems to be shifting somewhat. Industrials were a bright spot this year. What drove that strength?

**Phil:** Well, we'd call out RTX [Corporation] and GE (General Electric), which are leaders in aircraft engines, as key contributors [for the USD Accumulating Class]. Aircraft engines are a structurally attractive business. It has very high barriers to entry driven by engineering complexity. There's an oligopoly market structure, and, very importantly, aircraft engines drive long-duration, recurring services revenues at very high margins and the seeds to recent returns were sown many years ago. We took advantage of [COVID-19] pandemic-era dislocations to build positions in RTX and GE, and that patience really paid off in 2025.

**Kevin:** Another important area appears to be Communication Services. What are we doing there? It seems like results have been somewhat mixed so far.

**Phil:** It was a mixed bag in 2025. Alphabet was a key contributor [to the USD Accumulating Class] during the course of the year [based on absolute returns]. That's a company that had major controversy during the year over the future of its search business. Search advertisement revenue drives the bulk of profits, and there has been considerable overhang created by gen AI technologies.

We thought that the market was misunderstanding Alphabet's positioning in gen AI. Alphabet has a unique combination of proprietary semiconductors—that means it designs its own semiconductors. It has exclusive data sets for training through YouTube and Google franchises. Alphabet has a leading large language model with Gemini. It has robust distribution with the Google platform. So, this whole combination, [in] totality, no one can match. Plus, Alphabet has valuable franchises like Waymo and Android. Despite all these positive attributes, the stock traded under 16 times earnings during the course of 2025. It later recovered and was one of the key contributors during the course of the year [on an absolute basis].

Charter [Communications] and Comcast, by contrast, were key detractors [for the USD Accumulating Class]. The cable companies have lost subscribers to fixed wireless access and fibre overbuilds. However, we believe that there are limits to share loss and, importantly, Charter and Comcast have offensive weapons with mobile plan bundling. Earnings, in our view, held up better than headlines would suggest, and we see the outlook for free cash flow as particularly attractive. For Charter, capex (capital expenditures) will come down significantly in coming years, and we believe that the free cash flow generation of the companies are undervalued. Charter

and Comcast trade at mid-single-digit P/E ratios, and we believe the earnings are largely durable.

**Kevin:** So, in a fully valued market environment, we continue to find abundant opportunities, it sounds like, while maintaining our value-oriented approach. Before we wrap up, Phil, can you tell us a bit about how Dodge & Cox is evolving organisationally?

**Phil:** Yeah, Kevin, we've been around over 95 years, but we continue to be a learning organisation. We continue to look to enhance our research platform. During the course of the year, we've added analytical tools, including gen AI capabilities. We continue to look to make our investment process more iterative, collaborative, and free from behavioural biases. The goal, really, is to maintain the best parts of our long-standing culture—our deep research, our independence, [and] our long-term orientation—while continually improving the way we analyse companies and make decisions.

**Kevin:** Thank you, Phil. And finally, what's your message to shareholders as we head into 2026?

**Phil:** Well, Kevin, markets are expensive and we see many risks rising. However, many areas outside the mega-cap Information Technology complex are trading at compelling valuations. For long-term investors that take a disciplined approach, this is a great environment to find opportunities.

Our investment North Star never changes: valuation discipline, deep fundamental research, and a long-term investment horizon. This has been our guiding light for over 95 years through all kinds of market cycles, and we believe it remains the best path to generate superior long-term, risk-adjusted returns.

**Kevin:** Thank you, Phil, for joining me today and for sharing your thoughts on the U.S. equity markets, our performance, where we're finding opportunities, and your insights into the 2026 environment. We also want to thank those listening for your interest in our discussion.

**Phil:** Thanks, Kevin.

**Kevin:** We're grateful for the confidence you have placed in Dodge & Cox and look forward to speaking with you soon. Thank you.

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- 1 All returns are stated in U.S. dollars, unless otherwise noted.
  - 2 Unless otherwise specified, all weightings and characteristics are as of 31 December 2025.
  - 3 All Fund performance results are for the Dodge & Cox Worldwide Funds – U.S. Stock Fund's USD Accumulating Class.
  - 4 The use of specific examples does not imply that they are more or less attractive investments than the Fund's other holdings.
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