The Copeland Review

Second Quarter 2025

"We believe that stocks with sustainable dividend growth consistently outperform the market with less risk."

Let's Go to Vegas

"We are back. We are so back!!"

- Stu Price in *The Hangover*, Legendary Pictures, 2009

In the previous edition of the *Copeland Review*, "Severance," we counseled investors to look past any urges to act rashly, and instead to focus on making calculated choices, even as the major US equity indices fell. Acknowledging our inability to predict short-term market movements, we were nonetheless gratified to see discipline rewarded in the second quarter.

Indeed, following a decline of nearly 19% from mid-February to early April, the S&P 500 Index staged a record recovery (Chart 1)[1]. As in recent quarters, the Technology sector led both the downturn and the rally. After falling nearly 26% from their peak, tech stocks ripped upward 42% from April 8th through the end of the second quarter – the most dramatic 60 day move in any sector since 2009.[2]

Meanwhile, smaller cap stocks – represented by the Russell 2500 Index – also rallied nicely to close the quarter, but remain nearly 8% below their November 2024 peak.[2]

These performance results are especially remarkable given the Trump administration's aggressive stance regarding global trade. To be sure, the administration walked back some of the most egregious tariff hikes that came out of "Liberation Day" – at least temporarily – as it offered our trading partners the opportunity to strike new deals. Still, as the quarter closed, the average US tariff rate sat at 15.8% – its highest level since 1936! Moreover, since quarter-end, the President continued to threaten additional levies further exacerbating the trade climate.[3,4]

In this *Review*, we address three important points for investors to consider:

1. After a brief respite in the first quarter of this year, the speculative fervor that characterized the market during the fourth quarter of last year is "so back."
2. Driving the frenzy is an apparent belief on the part of investors that the Trump administration's trade policy will not present any challenges for inflation or economic growth.
3. The historically steep valuation discount weighing on dividend growth stocks, relative to the market, presents a potentially substantial opportunity for investors should recent biases moderate or reverse.

Fuzzy Memory

Stu: Why don't we remember a…thing from last night?

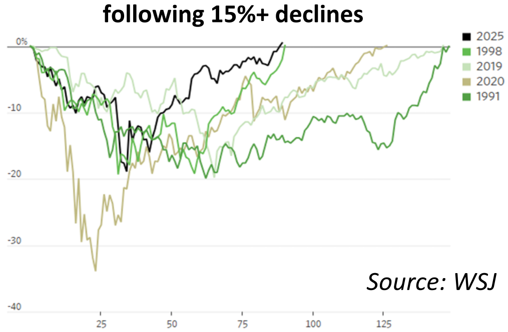
Phil: Obviously because we had a great…time.

In "Red Light, Green Light," our fourth quarter 2024 missive, we pointed out that risk-taking was rampant across the market capitalization spectrum:

- In the large cap space, investors ploughed into the "Magnificent Seven" driving the group's weight to nearly 35% of the S&P 500 Index from only 20% as the end of 2022.[5]
- In smaller caps, the excitement was even greater. Although none of the top ten performing names in the Russell 2500 Index were projected to be profitable through at least 2026, they rallied nearly 500% on average. Hope for quantum computing and AI featured heavily in the group.[5]

In the first quarter of 2025, the market briefly returned to a more general sense of skepticism with market participants temporarily taking fears of a trade war, inflation, and global instability to heart. The ten names that led the Russell 2500 in the fourth quarter fell -46% on average, and SMID cap Dividend Growth stocks, as measured by Ned Davis Research, outperformed non-dividend paying SMID cap stocks by over 900 basis points.[5,6]

Chart 1. S&P 500's quickest recoveries following 15%+ declines



Source: WSJ

Yet, as quickly as it vanished, risk-taking returned in the second quarter. Like Stu and Phil, many investors proved to have little memory of the lingering risks in the market, opting instead to jump back into the same kinds of stocks that drove the "great times" in the fourth quarter of last year.

Any way we cut it, "quality" stocks were, again, left in the dust while riskier segments of the market ripped.

Take, for example, the S&P Momentum Index's relative performance versus the S&P 500 Index. Over the last two years, momentum stocks outpaced the broader benchmark by more than 60%! Since at least 2005, no other two-year period has come close to that level of outperformance. Notably, most of the recent outperformance has accrued in only the last nine months – an incredible move for such a short period of time. By contrast, the relative performance of the S&P Quality FCF (Free Cash Flow) Aristocrats versus the broader benchmark – which was tracking roughly in-line with Momentum through the middle of 2024 – has since rolled over reflecting a strong investor preference for risk over quality (Chart 2).[7]

Similarly, within the Russell 2500, the least profitable stocks ran far ahead of their more profitable peers in the second quarter (Chart 3).[5]

Animal spirits appear to be "so back"!

But, wait. A word of caution is probably warranted. Unlike the guys from *The Hangover*, most people who go on a speculative gambling binge don't wake up with $80,000 in their wallets in the morning.

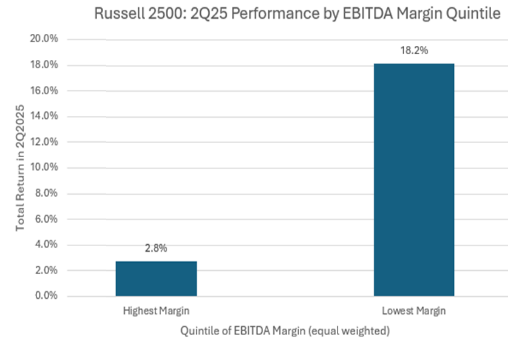
TACO Time?

Surprisingly, the relentless affinity for risk comes against a backdrop of the most protectionist US trade policy since the 1930s. To justify such a mania, one must assume that Trump's tariffs don't present a meaningful economic concern.

Investors who hold that sanguine view are likely operating on what has come to be known as the "TACO theory." Originally used

Chart 2. While "momentum" stocks (light blue) continue to rip, the relative performance of "quality" (dark blue) has rolled over

Chart 3. The least profitable quintile returned more than 6x the most profitable quintile in 2Q25



Source: FactSet, CCM. Past performance is no guarantee of future results. The Russell 2500 Index is unmanaged, is not available for investment, and does not incur expenses. Past performance is no guarantee of future results. Please see the Disclosure section for important information.

by Financial Times journalist Robert Armstrong earlier this year, "TACO" refers to his idea that "Trump Always Chickens Out." Specifically, Armstrong suggested that, "the US administration does not have a very high tolerance for market and economic pressure, and will be quick to back off when tariffs cause pain."[8]

Through the end of the quarter, the TACO narrative has been just that – a narrative – as it seems increasingly clear that the President is NOT "chickening out," and tariffs are going to be higher moving forward than they have been in many years (Chart 4).

Consider Vietnam, the sixth largest importer to the US, accounting for 4.4% of all imports in 2024.[9] On April 2nd, President Trump announced that the US would apply a tariff rate of up to 46% on those imports moving forward.[10] The good news is that in early July the two countries came to an agreement reducing the levy to 20%.[11] The bad news is that over the last decade – during which Vietnamese imports to the US have more than tripled – the "trade-weighted average Most-Favored Nation" tariff rate applied to Vietnamese imports was a meager 2.2%.[12,13]

Thus far, it has been challenging to ascertain any impact from the tariffs on the aggregate inflation numbers, which have remained muted (Chart 5).[14]

Beneath the surface though, moderating shelter inflation has masked accelerating price increases in other categories since the tariff announcements (Table 1).[15]

Anecdotal evidence across industries ranging from athletic gear to industrial distribution suggests this may just be the beginning. In their most recent earnings conference calls, Nike and Fastenal each noted its intent to pursue price hikes in the coming months.[16,2]

In response to these and similar comments, along with evolving data, expectations for Federal Reserve ("the Fed") interest rate cuts continue to evolve as well. In September 2024 – when the Fed announced its first rate cut in four years – the median Federal Open Market Committee participant expected another 50 basis points of cuts in 2024, plus 100 basis points of additional cuts in 2025.[17] While the first part came true, as the Fed announced a quarter point cut in both November and December 2024, no further rate reductions have yet been instituted, and officials now expect two or fewer cuts by year -end.[18]

So Small They're Almost Invisible

Phil: [as he's leaving school] It's the weekend, Budnick. I don't know you. You do not exist.

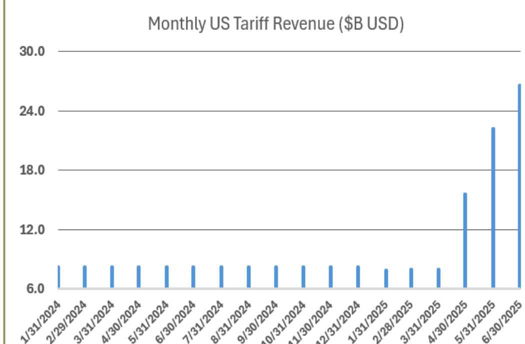
This policy climate is extremely unusual. On the one hand, we have lower taxation and expectations for significant deregulation. Yet, on the other, the prospect of inflation and persistently high interest rates is very real, whether driven by tariffs or immigration reform or both.

Normally, one might assume that in a period of such confusion, investors would seek stability and predictability. On some level, this has happened. Many investors have gravitated toward mega-cap growth stocks, attracted to their earnings and cash flow growth. However, among smaller caps, momentum has manifested in speculative, unprofitable leadership, as described above.

Market participants' fondness for mega-caps over small caps has persisted for several years and has now reached a fever pitch.

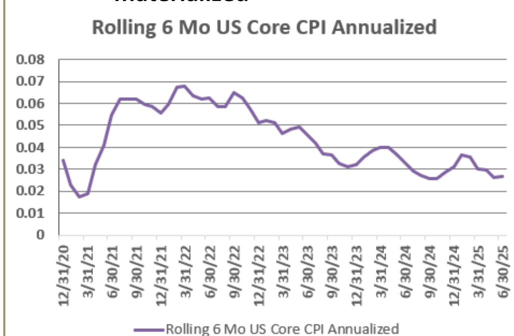
For perspective, between 2000 and 2018, the ratio of the collective market value of the largest five names in the S&P 500 Index versus that of the Russell 2000 Index ran between 0.7x and 1.4x. Today, that ratio is nearing 5x, having jumped sharply in the last two and a half years (Chart 6).[19]

Chart 4. Since March, the US' monthly tariff collections have more than tripled



Source: US Treasury Department

Chart 5. Inflation concerns have not materialized



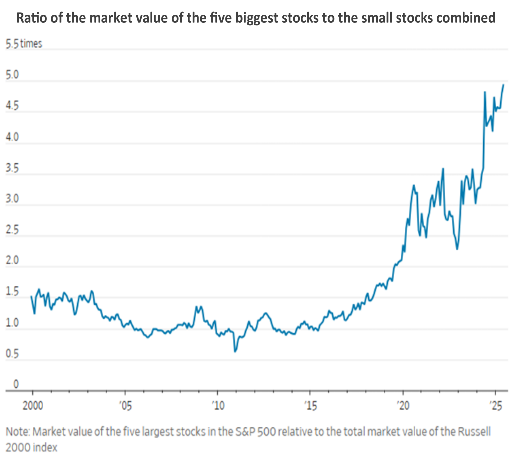
Source: St. Louis Federal Reserve

Table 1. Shelter inflation moderating while goods accelerates

Expenditure category	March 2025	June 2025	Acceleration from March to June
Toys	-0.9	1.8	2.7
Appliances	-0.1	1.9	2.0
Sporting goods	-0.6	1.4	2.0
Computers, peripherals, and smart home assistants	0.2	1.4	1.2
Household furnishings and supplies	0.0	1.0	1.0
Tires	0.3	0.9	0.6
Shelter	0.2	0.2	0.0

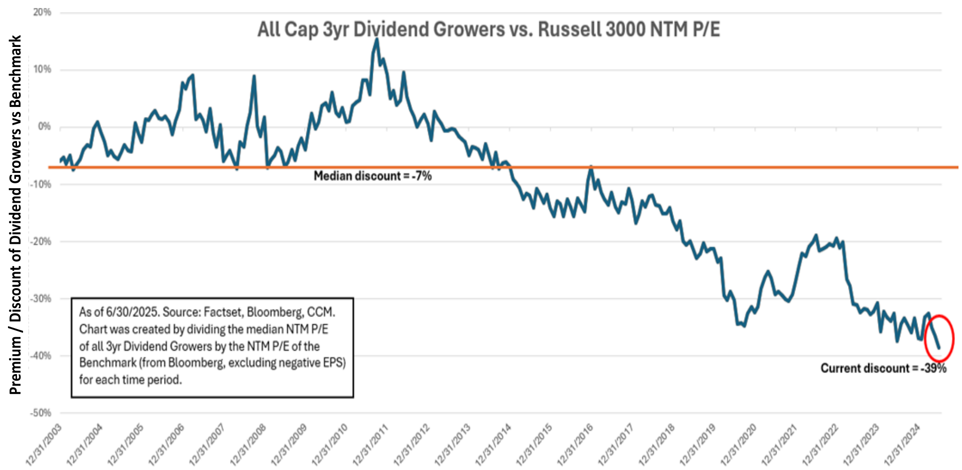
Source: Bureau of Labor Statistics

Chart 6. Five Mega-Cap Stocks Are Now 5x as the Entire Russell 2000 Index



Source: WSJ, Jefferies

Chart 7. All Cap Dividend Growth stocks are historically cheap



Source: FactSet, CCM. Benchmark data is sourced from Bloomberg and Dividend Grower data is sourced from FactSet. Both calculations exclude companies with negative earnings and use a weighted harmonic average NTM P/E. Dividend Growers include all cap companies that have raised their dividend for three consecutive years. Valuation discounts or premiums do not guarantee future returns will be greater or lower than the benchmark. There is no guarantee that companies will declare dividends or, if declared, that they will remain at current levels or increase over time. You cannot invest directly in an Index. For information on the Index shown above as well as other important information, please refer to the Disclosure section.

Like Budnick on a Friday afternoon, small cap stocks are an afterthought for many investors.

This phenomenon is, in part, a function of the favorable characteristics of some great mega-cap companies – several of which are Dividend Growers – but it also reflects specific conditions that have weighed heavily on smaller companies in recent years. Interest rates, inflation, and tariffs stand out, as smaller companies lack the scale and global supply chains that allow larger companies the flexibility to mitigate such challenges.

We don't know exactly when or how these conditions will be resolved, but we are gaining clarity as trade deals gradually trickle in. With this fog lifting, "worst case scenario" risk is likely receding, leaving investors better equipped to evaluate corporate outlooks with greater confidence.

The narrow market leadership, and market preference for risk over quality is best captured in Chart 7, illustrating the relative valuation of All Cap Dividend Growers versus the Russell 3000 Index.[5]

We believe this combination of extreme risk-seeking behavior on the one hand, and deeply discounted valuations on the other, has created a particularly dramatic opportunity for dividend growth stocks to outperform looking forward.

As we've often said, companies can engage in ill-conceived mergers or acquisitions, or authorize buybacks and never execute them. However, companies that raise their dividends do so for only one reason – their boards and management teams have strong confidence in the trajectory of the businesses.

Therefore, even during highly speculative times such as now, Copeland continues to focus on Dividend Growers and places a heavy emphasis on competitive advantages that allow for both strategic reinvestment in the business and rising capital returns. Historical evidence is strong that such companies tend to outperform their benchmarks over time, especially after periods when non-dividend paying and other lower quality stocks have outperformed.[20]

July 2025

1 *https://www.wsj.com/finance/stocks/historic-rebound-sends-s-p-500-to-new-highs-44775c62?gaa_at=eafs&gaa_n=ASWzDAhRycX_7bx4-sL3S_QmNcrLNqPDVAe76G7_dBHaBGBFqpPk95xKv7mV-FeQxkk%3D&gaa_ts=6862a30e&gaa_sig=Kn0JPqYkAqKjUMDyyz5KIcNvl3axhnHYcI8xXQjoV9SCmGWYZl7M0VYfbjO-6GO7oZUx2zXydltIObyFcyVf2Q%3D%3D*

2 *FactSet*

3 *https://budgetlab.yale.edu/research/state-us-tariffs-june-17-2025*

4 *https://www.tradecomplianceresourcehub.com/2025/07/14/trump-2-0-tariff-tracker/*

5 *FactSet, CCM*

6 *NDR: This is not the performance of Copeland and there is no guarantee that investors will experience the same type of performance.*

7 *https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-sp-500-factor.pdf*

8 *https://en.wikipedia.org/wiki/Trump_Always_Chickens_Out*

9 *https://tradingeconomics.com/united-states/imports-by-country*

10 *https://www.vietnam-briefing.com/news/new-tariffs-on-vietnamese-exports-analyzing-the-new-tariff-framework.html/*

11 *https://www.mufgresearch.com/fx/vietnam-and-us-tariffs-the-devil-is-in-the-details-3-july-2025/*

12 *https://www.usitc.gov/research_and_analysis/trade_shifts_2019/vietnam.htm, https://ustr.gov/countries-regions/southeast-asia-pacific/vietnam#:~:text=Vietnam%20Trade%20&%20Investment%20Summary,($22.1%20billion)%20from%202023.*

13 *https://www.vietnam-briefing.com/news/us-vietnam-trade-relations-trump-impact-tariffs-vietnamese-exports.html/*

14 *https://fred.stlouisfed.org/series/CPILFESL, CCM*

15 *https://www.bls.gov/news.release/cpi.t02.htm*

16 *https://www.usatoday.com/story/money/2025/06/27/nike-prices-trump-tariffs/84387186007/*

17 *https://www.chase.com/personal/investments/learning-and-insights/article/fed-meeting-september-2024*

18 *https://finance.yahoo.com/news/fed-dot-plot-reveals-more-divided-central-bank-but-still-points-to-two-rate-cuts-in-2025-181721811.html*

19 *https://www.wsj.com/finance/investing/small-stocks-bargain-85034233?st=8otcAH&reflink=desktopwebshare_permalink*

20 *NDR: This is not the performance of Copeland and there is no guarantee that investors will experience the same type of performance.*

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Currency - Unless otherwise specified or disclosed, the currency used for data in the report is US Dollar (USD).

Certain charts herein contain publicly available data, but the data has been formatted by Copeland to allow for ease of reading.

The Indexes mentioned are unmanaged, are not available for investment, and do not incur expenses. With respect to the comparison of the Copeland strategies to their comparative benchmarks, the number of holdings and volatility of an unmanaged Index is different from that of an actively managed portfolio of Dividend Growth stocks. The **S&P 500® Index** is a market-capitalization-weighted Index of the stocks of 500 leading companies in major industries of the U.S. economy. The **Russell 2000® Index** is comprised of the smallest 2000 companies in the Russell 3000® Index. The **Russell 2500™ Index** measures the performance of the small to midcap segment of the US equity universe, commonly referred to as "smid" cap. The Russell 2500 Index is a subset of the Russell 3000® Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. The **Russell 3000® Index** measures the performance of the 3000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. The **S&P 500 Momentum Index** is designed to measure the performance of 100 stocks in the S&P 500 with the highest momentum scores, calculated based on risk-adjusted price returns. The **S&P 500 Quality Free Cash Flow Aristocrats Index** tracks S&P 500 companies that have maintained positive free cash flow for at least 10 consecutive years and score highly on free cash flow quality metrics. The **S&P SmallCap 600 Index** measures the performance of 600 U.S. small-cap companies that meet specific market capitalization, liquidity, and profitability requirements.

Definitions

Dividend Growth Rate - The annualized percentage rate of growth that a particular stock's dividend undergoes over a period of time.

EBITDA - Earnings Before Interest, Taxes, Depreciation, and Amortization, is a financial metric used to evaluate a company's operational performance and profitability. It measures a company's earnings before factoring in the effects of financing decisions (interest), tax expenses, and non-cash expenses like depreciation and amortization.

NTM – Next twelve months.

P/E Ratio – The Price-to-Earnings Ratio of a stock is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share.

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