A Conversation With

Kera Van Valen, CFA
Managing Director,
Portfolio Manager and
Senior Research Analyst,
TD Epoch

The Wonderful World of Yield

How would you describe the environment for shareholder yield investing at the moment - What is working well, and what is creating challenges?

The current environment is, in many respects, constructive for shareholder yield investing. Elevated volatility, geopolitical uncertainty, and shifting rate expectations have created greater dispersion across sectors, which tends to reward a bottom up, cash-flow-driven approach. In that context, companies with sustainable free cash flow and a track record of returning capital to shareholders have historically been able to deliver relatively resilient results. We have also seen a broadening of market participation beyond a narrow set of leaders, which which may support a more diversified yield opportunity set.

That said, challenges remain. Strong market performance in recent years has compressed dividend yields in parts of the market, making income harder to source if one looks narrowly at dividends. At the same time, certain segments, such as those driven by long-term growth expectations, continue to be influenced more by sentiment than by near-term cash generation. This creates a more selective environment, where the sustainability of cash flow and capital allocation discipline becomes even more critical. Ultimately, we see today less as a constraint and more as an environment that rewards rigor.

How has that impacted the performance of software stocks?

Valuations in the software sector have compressed significantly. The iShares Expanded Tech-Software Sector ETF (IGV) is down 20% year-to-date, dramatically underperforming the semiconductor index (SOX), which is up 11% year-to-date. One of the largest software companies in the world is down 23% year-to-date and down 31% from its all-time high in September of 2025. This is despite the company's earnings estimates having continued to meaningfully increase over the past year. It is a clear disconnect with the fundamentals, particularly as the company is also a prime beneficiary of the AI supercycle with its own offering showing 15 million paid seats and elevated GPU allocation due to increased usage as of the most recent earnings report, had. That was in addition to strong growth in the company's cloud business. Investors continue to reward the semiconductor sector (chip makers, semicaps, memory, storage, optical) as the builders of the AI supercycle while punishing application software stocks as AI losers.

You've long argued that shareholder yield is about more than just dividends. In today's market, where are investors still thinking too narrowly about income opportunities?

When thinking about yield, many often think about a limited set of traditional income sectors, reinforcing the perception that yield must come from slower-growth, defensive industries. In reality, yield can be found in all sectors if you know where to look. The technology sector, for example, has traditionally been known as a low-dividend sector. This may have caused investors to ignore the sector when looking for yield. While our portfolio has traditionally been underweight in the sector and remains so today, we have generally been able to find companies paying a dividend that we find attractive in the sector. In addition, as the sector has matured and many of its largest companies have started to pay dividends, the opportunity set has increased. Something that may be missed by the casual observer. It is also important to note that sectors are not homogenous, there are differences in the sub-sectors that make it up. Take health care, for example. A biotech company may be focused solely on research and development (R&D) and unable to pay a dividend, but a large pharmaceutical company with strong, recurring, cash flow growth might be able to invest in R&D and return cash to shareholders at the same time.

The other main way in which investors may think about income too narrowly is that they equate yield solely with dividend yield, treating it as a simple, backward-looking measure of income the only source of cash return. In our view, that is incomplete because dividends represent only one way a company can return its free cash flow to shareholders. Share buybacks and debt reduction are also meaningful forms of value transfer (or yield). When a company buys back its shares, the number of shares outstanding falls and, thus, the value of each share increases. Similar to a dividend, value is transferred to the remaining shareholders, albeit through a different mechanism. Debt reduction is less obvious but still fits the same framework. When a company pays down debt, it uses cash that could otherwise be distributed. In return, the company reduces interest costs, improves future earnings, lowers financial risk and strengthens the balance sheet. Reducing debt effectively transfers value from creditors to equity holders because there are fewer claims on future cash flows. So while you don't receive cash immediately, you should benefit through higher future earnings available to shareholders.

In previous interviews, you've spoken about the "trinity" of dividends, share buybacks, and debt reduction. Which of those capital allocation levers is most attractive in today's market, and where are you seeing management teams become more disciplined?

From our perspective, the three components of shareholder yield – dividends, buybacks, and debt reduction – are best thought of collectively rather than in isolation. The key question is not which lever is most attractive, but whether the underlying free cash flow can sustain and grow total distributions over time. That said, in today's environment, we are seeing encouraging trends across all three. Dividends remain a core component of return and continue to anchor investor expectations. At the same time, buybacks have become more prevalent as companies deploy excess cash in a flexible way, particularly where balance sheets are strong. Debt reduction has also taken on greater importance, as higher interest rates incentivize companies to strengthen their balance sheets. What stands out most is the increasing discipline in capital allocation decisions, particularly among large, mature companies.

One of the more interesting aspects of the portfolio today is the exposure to technology and AI-linked businesses like Broadcom and Texas Instruments. What has changed in tech to make it a legitimate hunting ground for shareholder yield investors?

As I mentioned, the idea that shareholder yield investing is limited to traditional, high-dividend sectors is becoming increasingly outdated. Many technology companies have matured into highly cash-generative businesses, with strong margins and recurring revenue models that support consistent free cash flow. As these companies evolve, we are seeing a shift in capital allocation, with a greater willingness to return cash to shareholders through dividends and buybacks. At the same time, they have continued to benefit from structural growth drivers, including digitalization and AI. The combination of innovation and meaningful cash returns is entirely consistent with our philosophy. It underscores that shareholder yield is not a sector bet, but a framework grounded in cash flow and capital discipline.

You've previously said the real AI opportunity isn't the hype cycle, but the companies that can convert AI into stronger free cash flow and capital returns. Where are you now seeing that play out in practice?

We tend to view the AI opportunity through a cash flow lens rather than a narrative-driven one. In our view, the real opportunity lies not in the most visible parts of the ecosystem, but in the businesses that can translate AI investment into durable cash generation that they ultimately return to shareholders. Importantly, that opportunity set is broadening. While much of the attention remains on semiconductors and hyperscalers, AI is increasingly extending to influencing other parts of the value chain like industrials, infrastructure, and service-oriented businesses, where cash flows are boosted by AI investments. In addition, the adoption of AI by companies in almost all industries may lead to productivity gains and efficiency improvements, which can drive incremental free cash flow. From our perspective, these derivative beneficiaries can be particularly compelling, as they often combine structural tailwinds with more attractive valuations and clearer paths to capital return.

The latest portfolio updates suggest you're finding opportunities in areas as diverse as packaging, media, banking, and consumer staples. What does that breadth tell you about the current opportunity set for global income investors?

The breadth we are seeing across sectors highlights one of the core strengths of the shareholder yield approach. Because we begin with free cash flow rather than sector classifications, we are generally led to a more diversified set of opportunities. This breadth also reflects the reality that strong cash flow generation and disciplined capital allocation are not confined to any one part of the market. In fact, innovation, scale, and competitive positioning are often key drivers of cash flow across industries. As a result, the opportunity set for global income investors is larger than it may appear at first glance, particularly when viewed through a total shareholder yield lens.

In recent commentary, TD Epoch exited positions where confidence around future shareholder returns had weakened. What are the key warning signs that turn a high-yield opportunity into a potential yield trap?

Yield can be a deceptively simple metric, and in some cases, a high yield can signal underlying risk rather than opportunity. One of the most common warning signs is a disconnect between yield and fundamentals, where a high dividend is not supported by sustainable free cash flow. We pay close attention to whether a company has the capacity to maintain and grow its distributions over time. Deteriorating cash flow, excessive leverage, or capital allocation decisions that prioritize short-term payouts over long-term health can all be red flags. In addition, a rising yield driven by a falling share price often warrants further scrutiny. This is why we emphasize free cash flow analysis, which in our opinion, provides a clearer and more reliable foundation for assessing the sustainability of shareholder returns.

Can you give us two stocks you currently like and explain what makes them compelling shareholder yield opportunities today?

One of the newest additions to our portfolio is Scotts Miracle-Gro, which is a consumer-facing materials company that has well-recognized brands and leading market share in the lawn & garden industry in North America. The company generates significant free cash flow, pays an attractive, growing dividend, and is focused on reducing debt in the near term. Cash flows are generated from manufacturing, marketing, and selling consumer lawn care, gardening and controls products in the United States and Canada. Cash flow growth is driven by management actions to drive sales growth and deliver margin expansions, through innovation, customer activation, and e-commerce. The company rewards its shareholders with an attractive dividend. In addition, excess free cash flow is to be used for debt reduction in the near term as management's objective is to strengthen the company's balance sheet. Share buyback will follow when targeted leverage is within line of sight.

Within our top holdings is Cisco Systems, the world's largest network equipment provider, which designs, manufactures, and sells Internet Protocol (IP)-based networking and other products related to the communications and information technology (IT) industry. It also provides services associated with these products and their use. Cisco's cash flow is driven by a combination of network upgrades, expansions, and product refreshes. Cash flows are also increasingly derived from recurring services, such as providing added support and functionality, in addition to their hardware. Product innovation and its reputation for reliability and support help Cisco maintain industry-leading market share as well as strong margins relative to its peers. Modest capital needs outside of its R&D budget expenditures allow for strong and growing cash generation. Cisco expenses nearly all of its development work through R&D, driving innovation that allows Cisco to stay on the leading edge of product innovation. This is further supported by a modest capital expenditure budget. The company has committed to return in more than 50% of free cash flow back to shareholders in the form of dividends and share repurchases.

In today's concentrated and volatile market, how can a total return approach strengthen portfolio resilience and give investors confidence?

We believe that a total return approach grounded in shareholder yield provides a balanced and resilient framework for investing. Rather than relying on multiple expansion, which can be unpredictable, it emphasizes the components of return that are more observable and tangible, cash flow growth, and capital allocation. Over time, this tends to produce return profiles that are more consistent and less volatile than the broader market. By focusing on companies that generate and return cash, we believe investors can participate in equity upside while also benefiting from a degree of downside resilience. In today's more uncertain environment, we recognize that a combination of participation and resilience is particularly valuable, helping investors stay invested and compound returns over full market cycles.

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