



# Small Cap Value Equity

## Overview

The second quarter was a bumpy ride for the U.S. stock market. The rally that began late last year continued through April, was upended in May by renewed concerns about the economy and a more protracted trade war, then was revived in June by the Fed's clear pivot toward monetary easing. The June rally was enough to push major indices into positive territory for the quarter, capping a strong first half of the year which saw stocks up double digits. Returns were strongest for large cap stocks, but otherwise underlying market dynamics lacked discernable themes. Against this backdrop the Russell 2000® Value Index (RUJ) returned 1.38%, though only five of 11 economic sectors ended the quarter higher. Investors gravitated toward Financials, Industrials, Information Technology, Real Estate, and Utilities, highlighting their uncertain outlook on the economy and interest rates.

## Portfolio Performance & Developments

Cooke & Bieler's Small Cap Value Strategy returned 4.89% gross of fees (4.63% net of fees), handily beating the RUJ and building on its healthy Q1 outperformance. Favorable stock selection effect accounted for essentially all the excess return in Q2, with notably strong relative results in the Consumer Discretionary sector. The portfolio continued to see certain of last year's biggest detractors lead the charge, but as is frequently the case, our investment style also generated strong stock selection results in the Index's weakest sector, Energy.

## Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Winnebago	4.6	24.9	105
PGT Innovations	3.3	20.7	63
Air Lease	3.2	20.8	62
Steelcase	3.1	18.5	51
RenaissanceRe	1.9	24.3	47

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Schweitzer-Mauduit	3.4	-13.1	-50
Gates	1.9	-20.4	-46
American Eagle	1.1	-22.4	-40
Varex Imaging	2.2	-9.5	-24
Rush Enterprises	1.5	-12.4	-19

Source: FactSet

Past performance is not indicative of future results. The performance attribution is an analysis of a representative Small Cap Value institutional portfolio's gross of fees return relative to the Russell 2000® Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's Small Cap Value clients. To obtain the calculation's methodology and a list showing every holding's contribution to the overall account's performance during the quarter, contact your client service representative or email your request to [contact@cooke-bieler.com](mailto:contact@cooke-bieler.com).

## Largest Contributors

**Winnebago Industries (WGO)**, a leading designer and manufacturer of recreational vehicles, was the largest contributor this quarter. Fundamental performance within WGO's towable division continues to buck industry trends. Though industry-level concerns persist, investors seem to be warming to the company's long-term topline growth and margin expansion opportunities.

**PGT Innovations (PGTI)**, a specialty window manufacturer, was the second-largest contributor. PGTI's organic results were solid thanks to robust new construction growth and despite difficult hurricane-driven comparisons in its renovation and remodel business. In addition, its Western Window Systems acquisition performed better than expected, as market share gains offset weak industry dynamics in California.

**Air Lease (AL)**, an aircraft lessor, was the third-largest contributor. Investors seemed comforted by AL's ability to manage through delivery disruptions caused by the grounding of the 737 MAX and the bankruptcy of several international customers.

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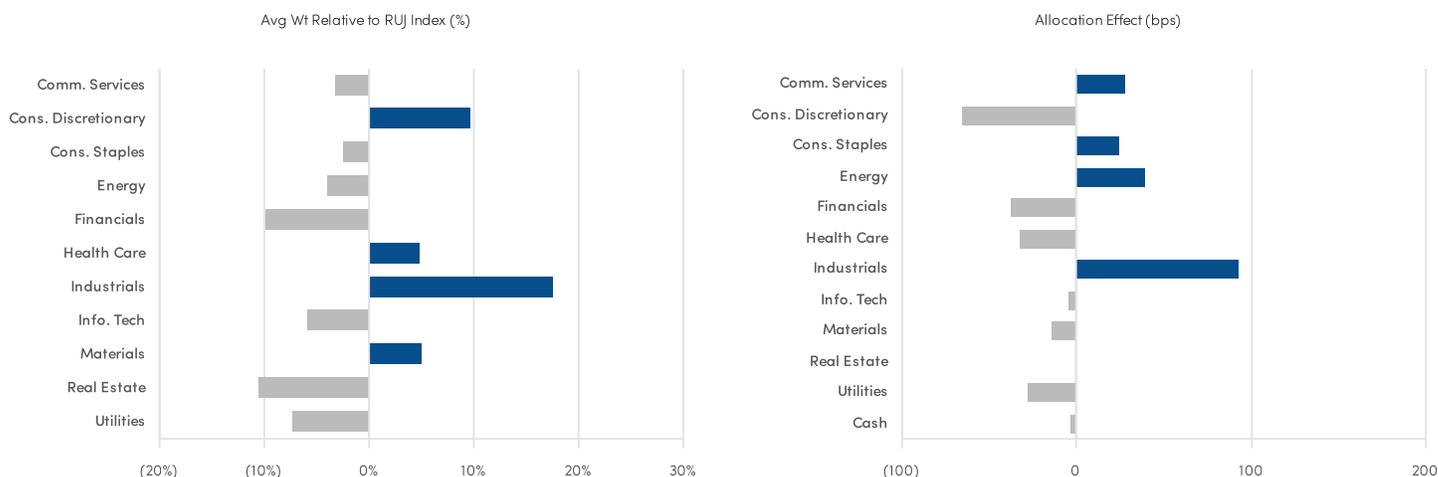
## Largest Detractors

**Schweitzer-Mauduit International (SWM)**, an advanced materials and engineered solutions provider, was the largest detractor this quarter. SWM was a top performer last quarter and this quarter's underperformance partially reflected a reversal of investor enthusiasm. Some fundamental volatility in reported results has investors more cautious on management's targets for the full year.

**Gates (GTES)**, a global manufacturer of premium transmission belt and fluid power products, was the second-largest detractor. Roughly two-thirds of GTES' sales are to the more recurring and higher margin replacement channel, which experienced softness in the quarter related to unexpected inventory destocking. This, and more expected weakness in European and Chinese first fit sales in automotive end markets, led to disappointing quarterly results and lowered full-year guidance. Despite this setback, GTES' exposure to the replacement channel should serve to stabilize results over the long term while attractive organic and inorganic growth opportunities combined with an improving free cash flow profile provide attractive upside potential.

**American Eagle Outfitters (AEO)**, a teen and young adult retailer operating through the Aerie and American Eagle brands, was the third-largest detractor. A new holding this quarter, American Eagle shares were pressured by fears that escalating trade tensions could disrupt their supply chain and concerns that management's margin expectations for the second half of the year were overly optimistic. The stock's weakness provided the opportunity to add to our position throughout the quarter.

## Sector Positioning



Source: FactSet  
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Sector allocation effect was approximately neutral this quarter. Underweight positions in the RUJ's worst-performing sectors – Energy, Consumer Staples, and Communication Services – and an overweight in Industrials were additive. This impact was partially offset by the negative effects of the portfolio's meaningful underweight in Utilities as well as the overweight in Consumer Discretionary, Health Care, and Materials. Exiting the quarter, the strategy remains underweight the high-yielding Utilities and Real Estate sectors and broadly overweight economically sensitive sectors including Industrials and Consumer Discretionary. Energy continues to be a significant underweight and partial offset to the portfolio's pro-cyclical tilt.



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## Initiations

**American Eagle Outfitters (AEO)** is a teen and young adult retailer operating under two brands: American Eagle and Aerie. Aerie is a women's innerwear concept that appears well positioned for long-term growth. AEO's valuation does not accurately incorporate this potential, and investor concern surrounding China trade tension gave us the opportunity to initiate a position.

**Kadant (KAI)** supplies high-value critical components and engineered systems used in the papermaking, wood processing, and material handling industries. Entrenched as the market leader with a large installed base and significant consumables content, KAI has significant competitive advantages. Concerns about near-term sales declines in their papermaking segment are obscuring the significant runway KAI has to compound value by further improving operations and expanding through bolt-on acquisitions.

**MKS Instruments (MKS)** supplies components and subsystems to companies in the semiconductor capital equipment industry, among others. MKS's growth strategy of adding more content per customer system as well as expanding into adjacent markets has proven effective. Recent concerns about the level of semiconductor capital equipment spending created a buying opportunity.

## Eliminations

**Fox Factory (FOXF)** was eliminated after reaching its price target.

## Outlook

Bumpy quarters like Q2 tend to reinforce investors' short-term focus. But rather than try to guess the next twist in the market, we find it more profitable to look to the long term and focus on fundamentals. Taking the long view, over the last 15 years – a period that saw two oil price spikes, a global financial crisis, unprecedented monetary intervention, and countless political shocks – the RUJ has generated a fairly typical 7.3% annualized return. In other words, the confusion and cross currents of the second quarter are par for the course, presenting an opportunity to profit from others' impatience rather than a cause for alarm for long-term oriented investors. From a fundamental standpoint, the business environment remains mostly positive, albeit with pockets of weakness emerging as trade tensions begin to take their toll. Valuations, broadly speaking, seem fair – neither compellingly cheap, nor worryingly expensive. This combination leads us to believe returns will be volatile, but positive over time. We remain confident that our long-term approach and disciplined focus on fundamentals, balance sheets, and valuation are well suited to profit both from the opportunities created by volatility as well as the long-term compounding ability of quality businesses.

Sources: Bloomberg; FactSet; FTSE Russell; Market Watch; The New York Times; T. Rowe Price

Past performance is not indicative of future results. The material presented represents the manager's assessment of the Small Cap Value institutional portfolio and market environment at a specific point in time and should not be relied upon by the reader as research or investment advice regarding any particular security or sector. The above commentary and portfolio attribution are based on a representative Small Cap Value institutional portfolio for the quarter ending 6/30/19. The portfolio attribution is gross of fees. Certain client portfolios may or may not hold the securities identified above due to the respective account's guidelines, restrictions, required cash flows, or other relevant considerations. The performance attribution is an analysis of the portfolio's return relative to the Russell 2000® Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's Small Cap Value clients. To obtain the calculation's methodology and a list showing very holding's contribution to the overall account's performance during the quarter, contact your client service representative or email your request to [contact@cooke-bieler.com](mailto:contact@cooke-bieler.com).

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