COOKE & BIELER

Q4 2019

# Small Cap Value Equity

## Overview

U.S. equity markets ended the year on a very strong note, with indices reaching record highs. Investor optimism was buoyed by easing trade tensions and indications of diminishing recession risks. Interest rates rebounded meaningfully during the quarter after declining most of the year. Against this backdrop, the Russell 2000® Value Index (RUJ) generated an 8.49% return. Notably, growth outperformed value and bond-proxy sectors underperformed the broader market. For the full year period, US equity indices – soothed by the Fed's accommodative monetary policy pivot – were up broadly and significantly, posting returns upwards of 20%, with particular strength in Technology. Volatility receded from very high levels in 2018.

## Portfolio Performance & Developments

Cooke & Bieler's Small Cap Value Strategy returned 11.64% gross of fees (11.37% net of fees), outperforming the benchmark for the quarter and extending its YTD lead. Stock selection and sector allocations contributed about equally to outperformance. Stock selection results were positive in most sectors where the portfolio had weight, led especially by strong performance in Information Technology, Financials, and Consumer Discretionary. Underperformance in Health Care holdings represented the only detractor from relative results. From an allocation perspective, the strategy's underweight to bond-proxy sectors boosted relative results. Over the full year, the strategy outperformed the RUJ by 13.15%, net of fees. Stock selection accounted for approximately 90% of outperformance, with Industrials, Materials, and Consumer Discretionary stocks having the strongest positive impact.

## Five Largest Contributors/Detractors

| | Avg Weight (%) | Total Return (%) | Contrib. to Return (bps) |
|---|---|---|---|
| Winnebago Industries | 4.6 | 38.1 | 165 |
| Cohu | 2.0 | 69.7 | 110 |
| Colfax | 3.3 | 25.2 | 81 |
| TCF Financial | 3.1 | 24.0 | 71 |
| Plexus | 2.8 | 23.1 | 69 |

| | Avg Weight (%) | Total Return (%) | Contrib. to Return (bps) |
|---|---|---|---|
| PGT Innovations | 3.4 | -13.7 | -49 |
| Gildan Activewear | 2.9 | -16.4 | -46 |
| American Eagle | 2.9 | -8.5 | -33 |
| Hexcel | 2.3 | -10.5 | -26 |
| FirstCash | 1.9 | -11.7 | -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.

## Largest Contributors

**Winnebago Industries (WGO)**, a leading manufacturer of recreational vehicles and towables, was the largest contributor. WGO reported continued market share gains in the face of industry weakness and completed the attractive acquisition of Newmar, a high-growth, luxury RV manufacturer.

**Cohu (COHU)**, a provider of back-end semiconductor equipment and services, was the second-largest contributor. After a dire outlook for the semiconductor industry at the beginning of 2019, investors shifted focus to the upcoming 5G cycle and continued deployment of technology to drive productivity. Investors also became more optimistic about the industry's supply and demand imbalance. Despite COHU's near-term fundamental results showing little change, it outperformed in the quarter due to these shifts in investor perspective.

**Colfax (CFX)**, an acquisitive conglomerate with strong welding and orthopedic franchises, was the third-largest contributor this quarter. CFX had strong fundamental performance in both their segments, with their ESAB welding business continuing to show good margin improvement. The company also benefited from the execution of a successful Analyst Day in December that gave further insights into their newly acquired orthopedic franchise, DJO Global. Initial results of the acquisition have been positive, with integration moving along and DJO posting better than expected organic growth.

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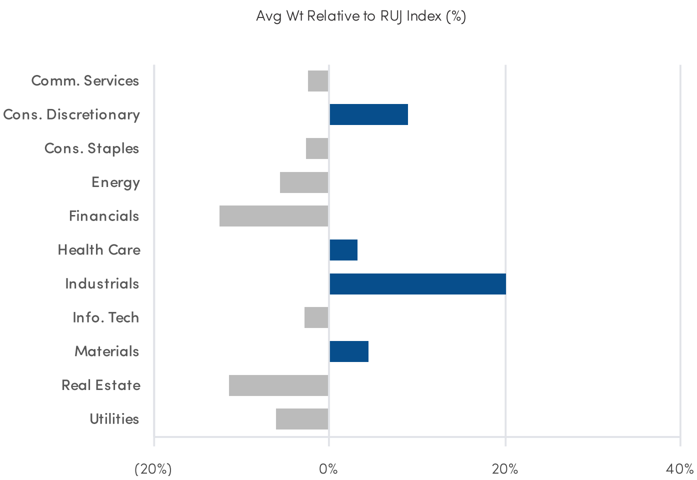
## Largest Detractors

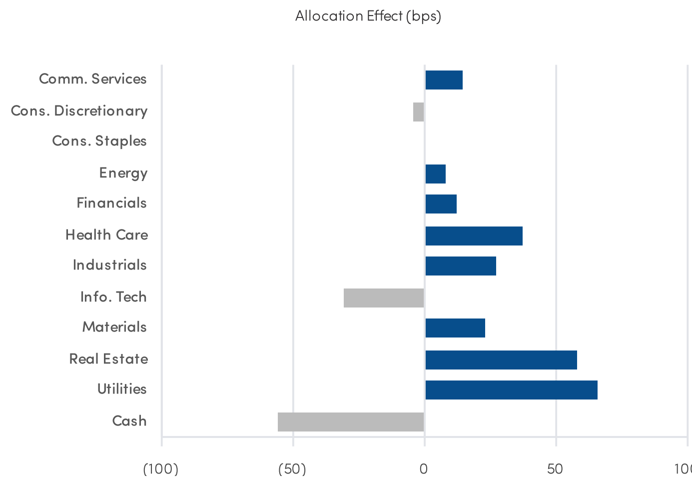
**PGT Innovations (PGTI)**, a leading manufacturer of laminated, impact-resistant windows, was the largest detractor. PGTI continued to face difficult comparisons following last year's surge in demand for its impact-resistant windows.

**Gildan Activewear (GIL)**, the largest basic apparel manufacturer, was the second-largest detractor. GIL lowered full year guidance due to an industrywide pullback in corporate end-user demand for printwear products, despite strong innerwear sales and margin expansion potential.

**American Eagle Outfitters (AEO)**, a retailer of denim and other fashions through their American Eagle and Aerie brands, was the third-largest detractor. AEO underperformed due to disappointing holiday sales guidance and a rise in inventories. Momentum in their core denim franchise and Aerie innerwear concept remains strong, and the market continues to undervalue the company's strong brands, experienced management team, and conservative balance sheet.

## Sector Positioning




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 sector return relative to the Russell 2000® Value Index. Please see additional performance disclosures at the end of this document.

Approximately 50% of the quarter's outperformance was explained by sector allocation effect, which was positive in eight of 11 economic sectors. The portfolio's underweight in Utilities and Real Estate had the largest positive effect as these perceived safe havens lagged the overall benchmark. The portfolio's overweight to Health Care, Industrials, and Materials was also additive. The portfolio's overweight to Consumer Discretionary was a headwind as was its underweight to Information Technology, the RUJ's best performer for the quarter. Over the full year, sector allocation effect was positive in the majority of sectors, with an underweight to Energy and overweight to Industrials delivering the strongest results.

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## Initiations

**Acuity Brands (AYI)** manufactures and distributes indoor and outdoor lighting fixtures and control systems. It is the leader in the commercial space and #2 in residential, with 85% of its sales deriving from commercial end markets. AYI has been investing in networking capabilities that equip its lighting fixtures with building controls, such as power usage control, and that provide data collection/analytics used in various applications such as traffic flow management, positioning, and asset tracking. Even assuming normal margins well below the company's recent peak and giving it minimal credit for any networking potential, we believe AYI presents a compelling long-term value.

**Integra LifeSciences (IART)** is an acquisitive global medical technology company whose successful core tissue regeneration technology has leadership positions in neurosurgery, advanced wound care, and orthopedic hardware markets. IART has a demonstrated track record of intelligent and well-integrated acquisitions and divestitures, most recently acquiring and integrating Codman Neurosurgery to become the #1 global neurosurgery player. Going forward, solid organic growth with a nice mix of stable and high growth end markets, improving gross margins, and some operating leverage should lead to strong operating cash flow at the same time capex and one-time Codman investments normalize lower.

**Stoneridge (SRI)** primarily serves the passenger car, light truck, and commercial vehicle markets, supplying actuation devices, electronic sensors, and vehicle instrument cluster systems. SRI is likely to outgrow its end markets driven by strong backlog in its core segments and roll out of its vision-camera system called MirrorEye, which would replace Class 5-8 vehicle exterior mirrors. New executive leadership continues to drive margin improvement and a high level of accountability. With strong financial flexibility and continued investments, SRI has the potential to own a large platform – instrument cluster, vision & safety, and connectivity – in the commercial vehicle space.

## Eliminations

**Mednax (MD)** was eliminated due to concerns that its fundamentals will be secularly challenged.

**Quanex Building Products (NX)** was eliminated to make room for better opportunities.

## Outlook

Looking forward, we are cautiously optimistic. Fundamentals remain strong in the portfolio, but valuations have risen to more demanding levels. Our pro-cyclical tilt benefitted performance in 2019 as recession fears moderated, but could be less of a tailwind going forward. Nonetheless, we remain confident in the portfolio's positioning and our ability to identify reasonably priced stocks of high quality businesses that will add value over the long term. All things considered, the market likely will be more volatile in the new year, creating opportunities for investors like us. We remain committed to ensuring portfolio turnover as necessary, with the knowledge that timely eliminations are as important as initiations to strengthen the portfolio.

Sources: APX, Bloomberg, FactSet, Forbes, S&P Global, The Wall Street Journal



Additional Cooke & Bieler Small Cap Value Performance Disclosures