



# SMID 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 2500™ Value Index (R25IV) generated an 7.07% 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 SMID Cap Value Strategy returned 9.28% gross of fees (9.04% net of fees), outperforming the benchmark for the quarter and extending its YTD lead. Stock selection and sector allocations both contributed to outperformance. Led by strong performance among Materials, Financials, and Information Technology holdings, stock selection results were positive in all sectors where the portfolio had weight except Health Care. From an allocation perspective, the strategy’s underweight to bond-proxy sectors boosted relative results. Over the full year, the strategy outperformed the R25IV by 15.52%, net of fees. Stock selection accounted for approximately 75% of outperformance – all sectors where the portfolio had weight were additive YTD, with Materials, Consumer Discretionary, and Financials stocks having the strongest positive impact.

## Five Largest Contributors/Detractors

	Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)		Avg Weight (%)	Total Return (%)	Contrib. to Return (bps)
Winnebago Industries	4.7	38.1	166	Gildan Activewear	2.7	-16.4	-43
TCF Financial	3.2	24.0	72	PGT Innovations	2.1	-13.7	-30
Colfax	2.9	25.2	70	American Eagle	2.7	-8.5	-28
Plexus	2.7	23.1	67	Hexcel	2.3	-10.5	-23
Reliance Steel	2.4	20.8	54	FirstCash	1.6	-11.7	-18

Source: FactSet

Past performance is not indicative of future results. The performance attribution is an analysis of a representative SMID Cap Value institutional portfolio’s gross of fees return relative to the Russell 2500™ Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler’s SMID 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 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.

**TCF Financial (TCF)**, a leading Midwestern regional bank, was the second-largest contributor. The company showed early integration progress following its merger with Chemical Financial in the third quarter of 2019. The combined entity has significant opportunities for both cost savings and revenue synergies as they combine TCF’s consumer-focused deposit franchise with Chemical’s commercial loan capabilities. Having lagged earlier in the year, the stock remains attractively valued.

**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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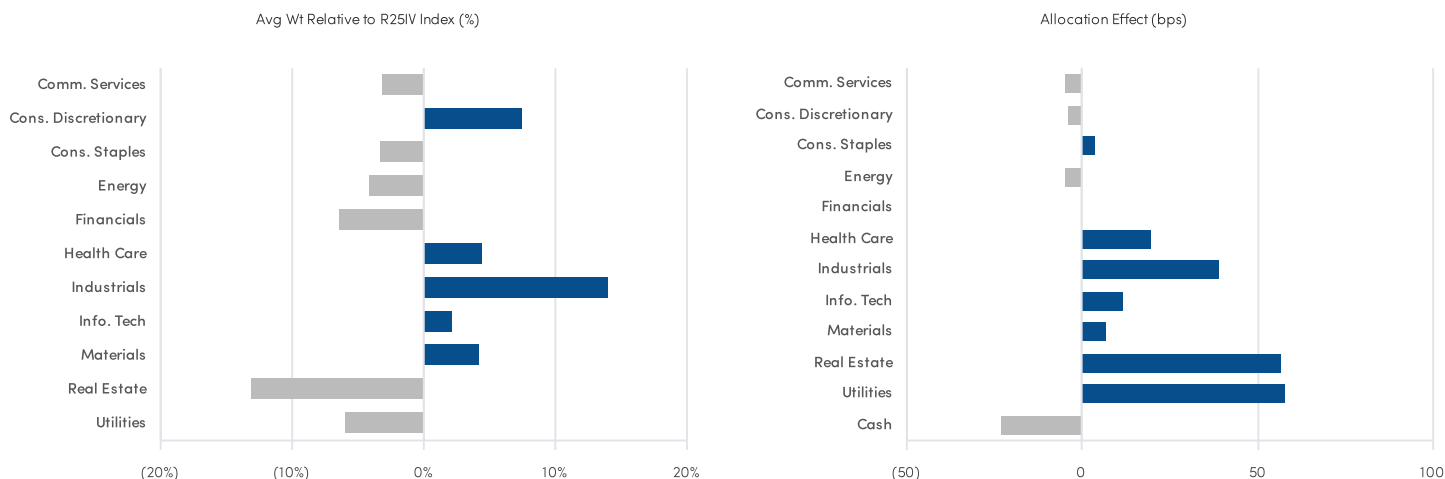
## Largest Detractors

**Gildan Activewear (GIL)**, the largest basic apparel manufacturer, was the 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.

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

**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  
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The majority of the quarter's outperformance was explained by sector allocation effect, which was positive in seven 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 Industrials, Health Care, and Information Technology was also additive. The portfolio's underweight to Communication Services and Energy was a headwind, as was its overweight to Consumer Discretionary. 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.

**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, with room to compound value by further improving operations and expanding through bolt-on acquisitions.

## 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, S&P Global, The Wall Street Journal

Past performance is not indicative of future results. The material presented represents the manager's assessment of the SMID 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 SMID Cap Value institutional portfolio for the quarter ending 12/31/19. 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 2500™ Value Index. The holdings identified do not represent all of the securities purchased, sold, or recommended for Cooke & Bieler's SMID 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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