All Cap Value Equity

Q1 2023

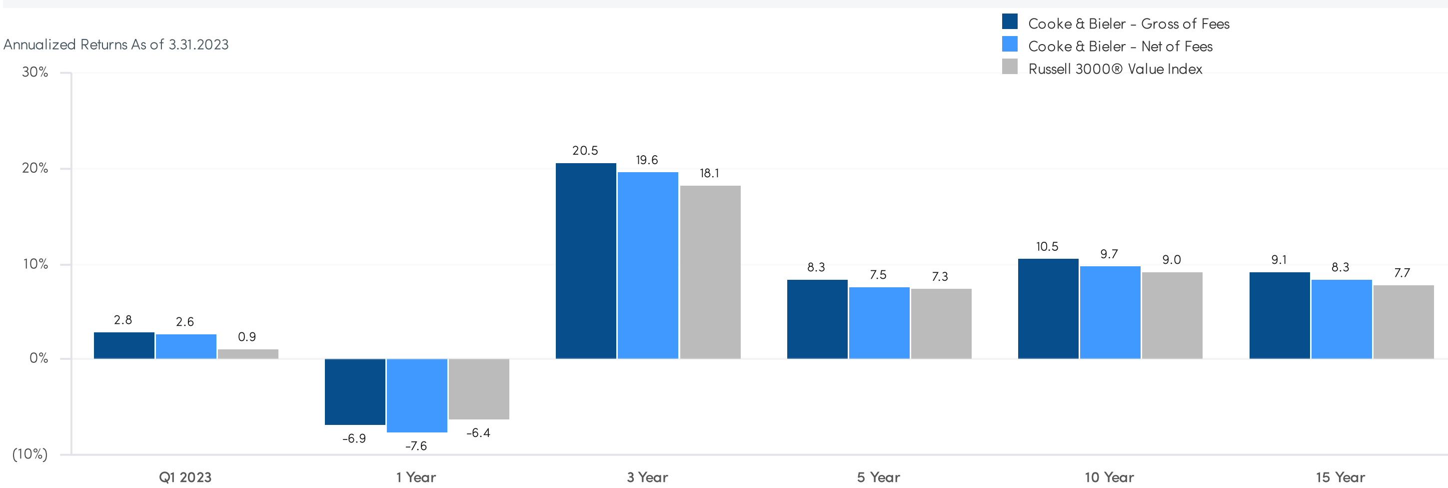
Overview

The first three months of 2023 have already taken markets on an eventful ride. Initially, investors indulged the bullish peak inflation and soft landing narratives that emerged in late 2022, fueling a broad rally through the end of January. Higher than expected inflation reports in early February, though, tempered that enthusiasm and spurred a retreat when hawkish Federal Reserve commentary pushed interest rates higher. By early March, that retreat further deteriorated into a deeper sell-off when several regional banks unexpectedly failed. Almost as quickly, fear gave way to optimism that the crisis would not be systemic. The Fed used its balance sheet to inject substantial liquidity into the banking system and investors embraced the possibility that central banks would change policy course sooner than later. The resulting late quarter market surge ultimately pushed most major equity indices into positive territory. Returns across investment styles, market capitalizations, and economic sectors varied widely, with growth indices advancing sharply, value indices posting flattish results, and large cap stocks outperforming small cap issues. At the sector level, the biggest winners were Information Technology, Communication Services, and Consumer Discretionary constituents – many of which posted double-digit returns. Energy stocks, on the other hand, followed the prevailing trend of last year's leaders becoming this year's laggards, while concerns about the liquidity of smaller banks weighed on Financials stocks at the lower end of the capitalization spectrum.

Portfolio Performance & Developments

Cooke & Bieler's All Cap Value Strategy outperformed the benchmark during the volatile first quarter, posting a 2.76% return gross of fees (2.57% net of fees) against the Russell 3000® Value Index's 0.91% return. Sector allocation effect and stock selection effect were both additive to relative results, with stock selection being the primary driver. Industrials and Health Care holdings – namely ESAB and Dentsply Sirona – were the most significant contributors. Financials holdings also added to results. Conversely, Communication Services holdings partially offset these results as all portfolio holdings underperformed the benchmark sector return. Consumer Discretionary holdings also continued to struggle, with Helen of Troy and Hanesbrands detracting most as investors continued to grapple with a potential recession amid mixed economic data.

All Cap Value Equity Composite Performance



Source: FactSet and Russell®

Past performance is not indicative of future results. All investing involves risk, including loss of principal.

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Contributors & Detractors

Largest Contributors

ESAB (ESAB), a manufacturer of welding and gas control equipment and consumables, was the largest contributor. Investors rewarded ESAB for strong execution, resulting in organic revenue growth and margin expansion. Following their recent spin-off, management continues to improve its communication to investors – particularly related to bolt-on opportunities within the gas controls space – improving investor sentiment.

PGT Innovations (PGTI), a leading manufacturer of laminated, impact resistant windows, was the second-largest contributor. PGTI generated strong quarterly results in an environment that has been challenging for most building products companies. Organic sales continued to grow thanks to the company's niche focus in attractive geographies as well as early signs of outsized strength for its impact-resistant windows following hurricane-driven awareness in the prior quarter. Additionally, potential interest from a strategic acquirer in late March pushed the share price higher.

Arrow Electronics (ARW), a distributor of electronic components and a solution provider to value added technology resellers, was the third-largest contributor. Investors rewarded ARW for strong execution as it achieved record sales and operating margins, despite a decrease in units sold. Investors generally favored the technology sector this quarter after worrying about the sector's growth prospects last year.

Largest Detractors

Charles Schwab (SCHW), a leading provider of investment services to individuals and independent investment advisors, was the largest detractor. The stock declined sharply as the market grew concerned about the unrealized losses in the company's large held-to-maturity bond portfolio. We believe these concerns are misplaced, as the company remains liquid and well capitalized and the mark-to-market losses – driven by increased interest rates – should reverse as the bonds mature over time.

Baxter International (BAX), a manufacturer of a diverse portfolio of lifesaving medical products, was the second-largest detractor. The company has struggled with extensive supply chain disruptions and pervasive input cost inflation over the past year, resulting in a series of earnings disappointments. Recent indications that these issues will continue to weigh on earnings in 2023 pressured the stock's valuation meaningfully.

PNC Financial Services (PNC), a super-regional bank with a strong credit culture and significant technological capabilities, was the third-largest detractor. PNC suffered from concerns about the stability of the banking system in the wake of the collapse of Silicon Valley Bank. Additionally, investors became increasingly concerned about the company's exposure to credit risk on commercial real estate loans.

Sector Positioning

Sector allocation effect was additive during the first quarter, with most sectors contributing to the strategy's outperformance. An underweight to Energy was the biggest tailwind as the sector faltered following strong performance in 2022. Overweight positions in Information Technology and Consumer Discretionary were also additive. Somewhat offsetting these positive results, an overweight to Financials was a headwind as the sector saw instances of indiscriminate selling following the collapse of multiple regional banks. While the strategy is overweight Financials as a whole, it is underweight banks, and we believe those in the portfolio are better capitalized and more conservatively positioned than the broader industry. An underweight to Materials, one of the better performing sectors within the benchmark, also detracted from results.

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Initiations & Eliminations

Initiations

Globe Life (GL) offers basic individual life and supplemental health insurance through niche distribution channels to underserved lower- and middle-income Americans. This marketing and distribution model combined with the company's scale and cost structure create a durable competitive advantage that is reflected in above average returns on equity and cash flow. Management consistently returns excess cash to shareholders, primarily through share repurchases.

Open Text (OTEX) is a software company serving predominantly enterprise customers. The company's portfolio of products includes enterprise content management, supply chain business network, security, and digital experience software. Many of these offerings are particularly sticky with customers and OTEX enjoys overall renewal rates over 90%. OTEX has high free cash flow margins which enable the business to either invest in research & development or acquire capabilities; the company has a strong track record of acquiring and successfully integrating adjacent businesses. OTEX is in the process of transitioning from selling traditional licenses to selling software subscriptions. Investor concerns that OTEX may experience difficulties integrating its latest acquisition gave us the opportunity to initiate a position.

Eliminations

Enovis (ENOV) was eliminated to make room for better opportunities.

Progressive (PGR) reached its price target and was eliminated.

Notable Stock Updates

Ritchie Bros. Auctioneers (RBA) owns and operates the leading auction marketplace for used construction, agricultural, mining, and transportation equipment. RBA completed its acquisition of previous portfolio holding **IAA (IAA)** in a stock-and-cash transaction during the quarter. We believe that the combination should accelerate RBA's promising satellite yard strategy and improve IAA's ability to service insurance customers during catastrophic events. We believe there are also significant opportunities for RBA's strong management team to create shareholder value by executing on cost and revenue synergies.

Outlook

Having shrugged off the failure of several regional banks and the forced consolidation of a large Swiss banking house, markets enter the second quarter with strong momentum. For the moment, investors seem inclined to take a constructive view of most developments, with strong data taken as a sign of economic resilience and weak data, or signs of financial stress, taken as evidence the Federal Reserve will soon end its year-long series of rate increases. There are clearly risks to this buoyant mood, however, as the effects of the Fed's dramatic tightening program are still materializing and we think more negative surprises seem likely. That said, we have long maintained that it is more productive to focus on company-specific fundamentals than to guess at macroeconomic outcomes. As always, we believe competitively advantaged businesses that create value for their customers, are conservatively managed, and are appropriately financed will generate attractive returns for their shareholders over time if purchased judiciously. Viewed in this light, economic dislocation creates more opportunities than risks for patient and disciplined investors.

Sources: Bloomberg, FactSet, The New York Times

Additional Cooke & Bieler All Cap Value Performance Disclosures